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Momentum Group AB (MMGR.B.SE)

Q4 2022 Earnings Call

CORPORATE PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the presentation of Momentum Group's Year End Report for 2022. I am Ulf Lilius, CEO of Momentum Group, and I'm here with my colleague Niklas Enmark, Executive Vice President and CFO and who will guide you through our reports today.

Our agenda is to give you some information about the highlights from Q4 and the development during the quarter, as well as information about the financial targets. We will round off with our growth strategy. And now I will go to the highlights of the report.

Overall, the business situation was satisfactory for the majority of our operation during the last quarter of the year, and we have strengthened our positions in our main markets in the Nordics during the year. The component [ph] shortages that marked the year has stabilized, but is still on a level that means longer delivery times the normal in certain product areas, which are some came some extraordinary work to ensure the availability of our products.

Our first year as an independent listed company has of course been marked by the anxiety that exists in the market. And therefore particularly proud that our operations continue to develop so well and at the same time demonstrate the ability to adapt based on the current market conditions.

Sales increased by 23%, where the group displayed organic sales growth of 11%. Well-managed price increases from suppliers and good cost control, together with acquisitions, led to the increase in EBITDA of 19% compared with the fourth quarter of the preceding year. Our financial target is to have an EBITDA growth by 15%. And to do so, we of course have to increase our sales. If we can grow a profit 15% five years in a row, we will double our earnings. In order to do so, we have to finance the expansion. We therefore have our super efficiency target of EBITDA through working capital to be larger than 45%. This is a simplified measure of cash flow, and the aim is to pay a dividend of one third. We also have to pay tax, which is around one third, and then we have one third left to invest, to grow and develop our business. And I'm therefore happy that the EBITDA for working capital remain stable at 61%. We also made the acquisition of Börjesson Pipe System, a leading player in sustainable flow technology solutions and products. Part of the purchase consideration was paid through a transfer of own Class B shares, which have been bought back within the framework of our share buyback program. And JOKRAB, which is active in regulations of automatics and pneumatics. It was our company Öbergs that acquired JOKRAB, as a daughter company, which points to the power of our decentralized business philosophy. After the reporting period, we also acquired Hydmos, which is a product offering an advanced hydraulic and gas system with high pressures and the acquisition strengthen the Group's offer in automation further.

Now I will hand over to Niklas, who will then guide you through our Q4 report and figures.

Niklas Enmark

Chief Financial Officer & Executive Vice President, Momentum Group AB

Thank you, Ulf. During the fourth quarter, revenue increased by 23% compared with a year earlier period and amounted to SEK 494 million. Growth in comparable units was 11%. The acquisitions of Börjesson Pipe System and JOKRAB completed in the fourth quarter. All in all acquisitions added 12% growth in the quarter, which included the same number of trading days as the corresponding quarter in the preceding year. During the quarter, our largest company, Momentum Industrial ended the year would help the revenue growth compared with the same quarter last year. Increases were noted in all customer segments. Sales were also strong for our specialist companies. For services the sales performance was slightly weaker during the quarter as some operations faced certain challenges in implementing planned workshop certain challenges in implementing planning workshop activities, particularly towards the end of the quarter due to increased sickness absence. As Ulf also mentioned, the business climate in our main markets in the Nordic region remained satisfactory, particularly in the industrial sector, which is the group's primary customer segment. The turbulence in the market have not yet had an intangible impact on customer behavior. The shortage of components that characterized the year has stabilized, but is still causing long delivery times in certain product areas. Under the circumstances, two companies are maintaining a high delivery capacity and have successfully offset the price increases.

Looking at the group's earnings, our EBITDA increased by 19% to SEK 56 million, corresponding to EBITDA margin of 11.3%. EBITDA was especially strong within our services companies with EBITDA margin of 14.1% during the quarter, especially so considering the challenges due to sickness absence I mentioned before. Operating profit rose by 37% to SEK 52 million, corresponding to an operating margin of 10.5%. Operating profit was charged with amortization of intangible non-current assets of SEK 4 million arising in connection with acquisitions and with depreciation of the right of use assets and tangible non-current assets of SEK 15 million. The main drivers of our profit expansion during the quarter where the organic sales development mentioned before acquisitions and also being able to compensate for the increased cost from suppliers through relatively stable gross margins. Also, our cost base is under good control where we see that the increases are due to acquisitions, increased activity related costs and to a limited extent due to increased costs related to energy and IT the latter two large part attributed to the upgrade of the ERP system in Momentum Industrial that will be fully implemented first half of this year.

Looking at the performance for the group for the full year 2022, our revenue rose by 17% to a bit more than SEK 1.7 billion. The increase in revenue for comparable units was 10%. The reporting period contained the same number of trading days as the year earlier period. Acquisitions added SEK 104 million to revenue corresponding to 7% revenue growth during the year.

Our EBITDA increased by 19% to SEK 204 million corresponding to an EBITDA margin of 11.7%. Operating profit rose by 19% to SEK 185 million corresponding to an operating margin of 10.6%. Operating profit included expenses affecting comparability of minus SEK 6 million related to the separate listing.

Earnings per share was SEK 2.7 per share, plus 17% for the reporting period. The board of directors has proposed a dividend of SEK 1 per share totaling approximately SEK 49 million in dividends, corresponding to a payout ratio of 37%.

And now to our business areas, and a few comments from business area. Firstly, the components business area. Sales and earnings in the components business area were positive during the fourth quarter and rose by 28% to SEK 400 million, compared to the same quarter last year, growth in comparable units was 15%, which was the highest increase seen during the previous year. EBITDA amounted to SEK 49 million corresponding to an EBITDA margin of 12.3%. Business areas profitability and assured us return on working capital was 6% to 9%.

Looking at the individual companies, Momentum Industrial reported favorable sales growth in the quarter driven by growth in all customer segments with especially strong and continued growth in the largest paper and pulp segment with 22%. Momentum Industrial reported growth in all product groups with the largest increase in SEK noted in rolling bearings. Momentum Industrial continued to make additional purchases of frequent items during the year to ensure high delivery capacity and conducted a major purchase in December to maintain availability into 2023. The specialist companies generally continued to perform well during the quarter with favorable demand and growth in sales and earnings. However, a more challenging market situation was experienced in Denmark and Germany and an action program was therefore initiated in HNC group.

The acquisitions of BPS and [indiscernible] closed during the quarter, with both companies contributing positively to the earnings trend. Hit most industry technique, which has a leading position in advanced developing systems for use in high pressure applications was acquired after the end of the quarter. The services business area performed well during the quarter, especially in terms of earnings. However, the business area sales performance was sixthly weaker as I mentioned during the quarter, as some operations faced certain challenges in implementing kind of workshop activities, particularly towards the end of the quarter due to increased sickness absence. That said, the revenue rose by 6% to SEK 9.9 million compared with the same quarter of last year. Revenue for comparable units measured in local currency and adjusted for the number of trading days, declined by approximately 2%.

Demand generally remains favorable with incoming work, good service capacity utilization and healthy component sales. For the full year, sales in comparable units in the business area increased by 14%. EBITDA amounted to SEK 40 million corresponding to an EBITDA margin of 14.1% unit quarter. Need tolerance, which was acquired during the third quarter, contributed positively to the business areas performance. The business areas profitability measured as return on working capital, continue to improve as stood at 62% at the end of the year.

The Group's profitability measured as return on working capital amounted to 61% for the reporting period. The return on equity for the same period was 29%. Cash flow from operating activities before changes in working capital for full year 2022 totaled SEK 185 million impacted among else by increase in supplement repayments regarding tax we have mentioned before.

During the year inventories increased by SEK 35 million, SEK 8 million during the last quarter, partly due to additional purchases of components or printing receivables rose by SEK 22 million, operating liabilities increased by SEK 7 million. Accordingly cash flow from operating activities for the reporting period amounted to SEK 135 million. Other items that affected the cash flow during the period were acquisitions, as well as net change in repurchases and sales of own shares of SEK 72 million.

IFRS 16 effects on cash flow is in total zero, but with a positive contribution to operations of SEK 50 million, of which SEK 30 million was in the last quarter, and the negative effect on financing in the same amount.

Looking at the financial position at the end of the period, the group's operational net loan liability amounted to SEK 48 million. Cash and cash equivalents, including unutilized granted credit facilities totaled SEK 961 million, meaning we have ample room for continued growth and a strong financial situation.

Looking at the earnings and profitability performance in relation to our financial targets. I should first mention that we see them as long-term objectives. Nonetheless, looking at them quarter-by-quarter, it is loss three years, we see that. Firstly our EBITDA growth quarter-over-quarter, was an average 18% for the period June 2019 until December 2022, which is then above the target level of 15%.

Our profitability of working capital has increased to 61% from 46% in March 2019 through gradual improvements in EBITDA 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 profit unit.

I would thereby like to hand over to you again, Ulf.

Ulf Christian Lilius

President & Chief Executive Officer, Momentum Group AB

Thank you, Niklas. Now, I will give you some input about our growth strategy going forward. Since our listing in March this year, we have acquired 70% of the shares in HNC Group. This September we also announced an acquisition of 7% of the shares in [indiscernible] which sells mechanical optical measuring machines for quality control for Swedish industrial customers.

In October we acquired Börjesson Pipe Systems, a leader in sustainable flow technology solutions and products. JOKRAB was the last acquisition made for the year and it was Öbergs that acquired JOKRAB as a daughter company, which points to the power of our decentralized business philosophy.

HNC, Mytolerans and JOKRAB are acquired via our proven model, where we initially acquire 70% and as an option to acquire the remainder after three years. In total, we completed four acquisitions during the year with a total annual turnover of almost SEK 175 million. The acquired companies will be run as independent niche company, all in accordance with our philosophy of decentralized business responsibility. After the reporting period, we also acquired f Hydmos, which has a product offering in advanced hydraulic and gas system with high pressures, and the acquisition strengthened the group's offering, not to mention further.

We have identified several product and service verticals where we would like to be present. We have grouped the companies in our three focus areas based on these. In the aftermarket group, we combine a strong value offer with a broad and deep product offering coupled with related services and expertise in industrial improvement. In our specialist companies, we focus on building expertise in a limited number of verticals per company. For example, [indiscernible] hydraulics [indiscernible] HNC Group in pneumatics automation and now BPS and Hydmos in flow technology solutions. The third focus area is technical services, where we today have companies that do maintenance service on and off customer sites, as well as like refurbishment of gear, motor, pumps, generators and spindle service. We also have companies working in measurement, quality assurance and optimization. We think a degree of focus is regarding business development and acquisitions on important success factor. As we grow and develop our offer market and knowledge, we can then add adjacent product verticals with limited risk and a higher chances for success. A decentralized business model is the key where we develop each company individually based on its and a higher chances for success. A decentralized business model is the key where we develop each company individually based on its own merits and as a group in the competencies in several industrial niches. Looking ahead, we have a strong platform and good businesses, which means that we can work with a strong focus on our selected product and service verticals. In order to grow our business, we focus on to develop employees and sustainable companies. For us, decentralized responsibility means investing in people where commitment, attitude and drive are as important as key figures and market shares. Our business philosophy is based on a decentralized responsibility for results with collaboration and partnership between the different companies in the business area where it is mutually beneficial. 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. To achieve this, we believe very strongly in the decentralized possibility as well as their 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. Bottom line, we're not that complicated. We acquire, we develop and we build

culture. If people grow, the business will grow, and that's sustainable for us. Our belief is that we have critical success factors in place to succeed with the strategy. We're financially strong with room for acquisitions. We have a strong cash flow from operations and the possibility of acquisitions financing through a revolving facility of SEK 800 million, where principal owners who want to grow the group in our desired position. We have a good industrial network both in Sweden, Denmark, Norway and now also Finland. We have proven we have a proven process and resources and a total around of 10 employees who work on acquisitions in various forms in place to evaluate and implement the acquisition, as well as a proven onboarding model with decentralized performance and business mobility. And we have competence in our field at several levels from the board and management as well as in our companies.

Q

So we have received some questions regarding the report, and I would start by asking the question and will get the answer, and I will do it the other way around. So first, good to see a positive demand message for 2023, is the outlook that the company will deliver on all its financial targets in 2023 based on this positive outlook?

A

That would be very nice, but we're not making any forward-looking assessment in that way. Our financial targets are defined over a business cycle, but of course, we are and we will be working with all the parameters, sales, costs of goods of sales, overhead and working capital, as well as acquisitions also this year.

Q

Okay. Thank you. Our supply chain is still tight, still – is there still a need to do a major purchase to maintain availability in 2023? Please elaborate.

A

Well, it is the trend that lead times in general has stopped increasing and in many cases have some come down. However, we still or as we also mentioned in the last report, experienced that for some products the lead time continues to be high in relation to pre-COVID situation. It is difficult to tell exact how long it will take before things are back to normal. As long as that situation prevails and we are seeing a good demand, we will continue to make extra stock purchases in order to have higher delivery capacity to our customers. However, we expect the level of these to be lower than in 2022.

Q

Thank you. Can you explain the gradual improvement in organic top line growth during the year where the 11% in the last quarter and especially business area components with growth of 15% organically is the strongest during the year?

This seems to point to a stronger underlying market. Is that right? It is true that we saw a strong finish over the year. We're both off the market business in momentum as well as the more product oriented business in specialist companies. So good demand or feeling is that we increased our market share towards our existing customers in

general, but also have some new, interesting customers. They exhibit growth, for instance, in the energy sector and Northvolt. We also have added effect of our Greenfields in Norway, where they are now gaining sales traction.

Q

Thank you. Last report, you commented that the expected ERP upgrade in momentum to go live in Q4. Now you're seeing first half of 2023 to be fully implemented. What is the reason for the delay and what benefits will you see arising from the upgrade?

A

Well, there are a few time windows during the quarter when you can go live due to the business environment, reporting, schedule and resources. We decided during the quarter to push the implementation forward due to one strong demand where we saw it's critical to not risk anything when it comes to supplied capacity and to as well as some adaptations that needed to be tested in Q2 before going ahead. Loaded benefits therapy is scalable, supporting, for instance, to scale up in Norway. There are also a number of new features, especially in logistics, which will make us more efficient.

Q

Thank you. The decrease in organic sales in the services you mentioned was caused by increased sickness absence towards the end of the quarter. Is that something you've seen also will spill over into Q1.

A

In some of the business, there still is an effect from higher sickness absence. The normal, however, is not the same magnitude as we had last year in Q1 where we have quite hit by the COVID pandemic. Of course, these things can change very rapidly, but as now we see that we can maintain a quite good capacity in our operations.

Q

Thank you.

Can you please elaborate on the organic growth, how much is volume and how much comes from pricing and can use to carry out price increases?

A

It's very difficult to give an exact answer as the composition of articles that we sell changes quite a lot from time to time. Due to them being spare parts to a large extent about price increases, yes, we still see price increases from our suppliers, which means we are still working with protecting our gross margins.

Q

Niklas, some financials questions. Gross margin looks to have slightly decreased year-over-year, is this primarily related to product mix or can you elaborate on what to expect going forward on the gross margin development.

A

And gross margins, year-over-year was actually higher than last year, but a bit lower in Q4 compared to the same quarter last year. This is more due to mix effects where we have where the share of revenue from services, where we have a bit higher gross margins. That share was higher in Q4 last year. Going forward, we are not taking we are not making any forward-looking statements in gross margins, however.

Q

Okay. Going to the company OpEx heading into 2023, higher salaries, increased rental rates, how do you work to manage these cost increases in order to maintain or improve the EBITDA margin, is it possible?

A

Well, first of all, the cost increase, as mentioned, are not new to us and we and they have been taken into consideration when doing the business planning for 2023. The tools for mitigating them are sales, volume, pricing, procurement and being cost conscious and efficient in our operations. This is something we work with in each of our companies of this individually and jointly will affect our EBITDA margins, we cannot comment as we are not providing those forward-looking statements.

Q

Okay, agency group action program, what they are planning and what outcome are you hoping for costs for the program during Q4?

A

Actions taken have included streamlining of the assembly and manufacturing operations in the company. Personnel layoffs and change of some middle management in the company. Costs have been taken the normal operations during Q4.

Q

Okay. Adjusting 2022 for acquisitions, it seems that the strong organic growth did not really deliver an earnings leverage. Similarly, I note that the gross margin expanded nicely. So is there an OpEx issue to be addressed here in the old operation?

A

And the earnings increase in the existing business is basically mirroring the increase in organic sales. This is derived from an increase in gross margins and a bit higher cost of sales. However, looking at the increase in cost of sales, this can be explained by increased activity and more active sales compared to the pandemic year or 2021, but also cost increases due to energy and freight. Also 2022, we have taken extra costs for the upgrade of ERP, et cetera that has a small but at least measurable effect on cost of sales.

Q

So asking you the final question Ulf, how is the pipeline for M&A doing? Is there potential to do four to six acquisitions per year? Is that too ambitious? Is it easier to find targets in Sweden than the other Nordics? And it's success stories based on new business combination towards customers when acquisitions have been brought in under the Momentum umbrella. Or is it really standalone rather than, say, synergies we should be looking for in acquisitions?

A

Well, first of all, the pipeline is doing very well. We continuously process a number of potential cases and filled the pipe with new prospects. We have also strengthened the organization during the year with skilled M&A resources. It is also very positive to see the strengthening of M&A capacity and our subsidiaries where [indiscernible] acquisition [indiscernible] was the first example.

Something we believe will be followed by more companies in the group. In these cases, the potential for synergies such as selling and customer offers are more valuable to expect. Going forward, we see that we will work with M&A on many levels in the group and we feel that the four to six acquisition, which will also include business outside of Sweden per year is absolutely doable, even though that is not a target we have set.

On a general note, we feel that more and more entrepreneurs our track for value proposition a long term focus. There are a lot of interesting partners out there for Momentum Group in our chosen product verticals and we have a very strong financial position basically being debt free.

Thank you for your time and interest listening to this presentation which are available with the report and the website of course. If you have any questions or specific requests, do not hesitate to contact us through our [ph] email or by phone. Once again, thank you very much and have a nice day.

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