Corrected Transcript

25-Aug-2022

Elekta AB (EKTAY.SE)

Q1 2023 Earnings Call

CORPORATE PARTICIPANTS

Cecilia Ketels
Head-Investor Relations, Elekta AB

Gustaf Salford
President & Chief Executive Officer, Elekta AB

Tobias Hägglöv
Chief Financial Officer, Elekta AB

OTHER PARTICIPANTS

Erik Cassel
Analyst, ABG Sundal Collier AB

Kristofer Liljeberg-Svensson
Analyst, Carnegie Investment Bank AB

Victor Forssell
Analyst, Nordea Bank ABP

Veronika Dubajova
Analyst, Citi

Rickard Anderkrans
Analyst, Svenska Handelsbanken AB

David Adlington
Analyst, JPMorgan Securities Plc

MANAGEMENT DISCUSSION SECTION

Cecilia Ketels

Head-Investor Relations, Elekta AB

Good morning, everyone, and warm welcome to the presentation of Elekta's First Quarter 2022/2023. My name is Cecilia Ketels, and I'm Head of Investor Relations at Elekta. With me here in Stockholm, I have Gustaf Salford, Elekta's President and CEO; and our CFO, Tobias Hägglöv, who will be presenting the results.

Today's agenda, start off with Gustaf presenting some highlights of the development and then Gustaf – Tobias will give you details on the financials, and the presentations end with Gustaf's view on Elekta's outlook. And after the presentation, there will, as usual, be time for your questions.

But before we start, I want to remind you that some of the information discussed in this call contains forward-looking statement. And this can include projections regarding revenue, operating result, cash flow as well as products and products development. And these statements involve risk and uncertainty that may cause actual result to differ materially from those set forth in the statements.

And with that said, I hand over to you, Gustaf.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

Thank you, Cecilia, and hello, everyone. And really thank you for joining the call here in the morning. And I would like to start with how we delivered on our strategy during Q1 and really moving towards an improved access to the best cancer globally.

So, if we look at our strategy, ACCESS 2025, and how we have executed during the quarter, you will see, for example, in supporting the strategic pillar of accelerating innovation, we launched Elekta Esprit, the new Leksell Gamma Knife platform during ESTRO in Copenhagen in May. And we received CE mark for Esprit this earlier this week, enabling people with brain disease, cancer and other tumors to benefit from the most advanced gamma knife platform.

We also continue to drive partner integration. One example is the strategic partnership between Kaiku Health, our leading digital therapeutics platform in cancer care, and Roche, a leading global healthcare company to deploy digital tools to provide real-time system management by patients and healthcare providers. We continue to drive adoption across the globe, and one example is that we got clearance for Harmony in China in the quarter. So, we now have local production of full Linac product lines in Beijing. This is really about Made in China for China.

Another example of adoption is the MR-Linac Consortium meeting in Houston, where that 75 members of the consortium presented advances in the clinical and technical research, utilizing the groundbreaking treatment platform and increasing adoption. But the primary focus during the last quarter has been on the resilience and process excellence initiatives across our organization to mitigate the current supply chain challenges. And in addition to the program, we're now launching a cost reduction initiative to support margin expansion going forward. And both Tobias and myself will come back to the initiative later in the presentation.

But I would like to also look at the order development, and you can see that EMEA and APAC reported healthy growth in the quarter, but Americas showed a decline and in total, orders declined by 11%. So, if we start in – with Americas, you see that the order decreased by 43%, and this decline was mainly explained by strong order level in the comparing quarter and also the year before in Q1, but also some underlying cautiousness in the US customers' investment decisions due to the macroeconomic uncertainties and longer decision processes.

On the positive side, we are happy to report that the second [ph] unit, the (00:04:20) MR-Linac, was ordered by RWJBarnabas Health in New Jersey and the first Leksell Gamma Knife ever was ordered to Panama. In EMEA, the order intake in Europe was supported by orders from the regional Spanish hospitals following the large public tender announced earlier, and a good development in other important radiotherapy markets such as Germany, France and the UK.

The Middle East and Africa continued to show growth, including a large order to Nigeria in West Africa, a comprehensive deal with Kaduna Cancer Center, including Unity, Harmony and Leksell Gamma Knife, really supplying the best available cancer care treatment opportunities to Nigeria.

Orders in APAC returned to growth despite a slower market in China due to the lockdowns. And during the first quarter, order intake increased by 9%. The growth was driven by the development in mature markets, such as Japan and Korea, but also the Indian market. One example from Japan is the order from Teikyo University Hospital, including in Harmony Pro and Kaiku. The Philippines and Indonesia where Elekta most recently opened sales offices continued to show good growth.

We also had more market and customer-facing activities in the quarter with increased physical customer activities. For example, ESTRO, AAPM, the consortium meeting, and that this is following a long period of restrictions and hybrid meetings. We also now see that our sales funnel is really developing well over the last couple of months and going into the second quarter. But if you look more on the revenue side, you see that Elekta experienced challenging market conditions in the quarter. Revenue grew but supply chain disturbances continued. Installations came in at a similar level as last year and service drove to growth in the quarter.

We increased our prices to mitigate the impact of inflation, but it would take some time before the increase is translated from our order backlog into higher profitability. The combination of continued headwinds from supply chain challenges, component shortages and increased inflation led to high cost levels and continued pressure on EBIT margin.

We expect these headwinds to continue during the year and impact our cost base. We are, therefore, accelerating our ongoing Resilience and Excellence Program and launching a cost reduction initiative to support margin expansion throughout the year. We plan to adjust the organization to the current situation and reduce our cost base with around SEK 450 million on a run rate basis by the end of this fiscal year. The initiative focuses on driving synergies between our business lines across regions and through a newly merged product development organization, and driving efficiencies in administration and support functions. Tobias will go through the initiative in more detail in the next section.

So, now, over to you, Tobias.

Tobias Hägglöv

Chief Financial Officer, Elekta AB

Thank you, Gustaf, and good morning, everyone. I will start this with covering the Q1 financials and then just as Gustaf mentioned here, finish my part with describing our cost reduction initiative in more detail. In the presented numbers, you'll find adjusted numbers, adjustments relate to items affecting comparability, which are cost taken for implementing our cost reduction initiative.

So, starting off with the Q1 financials. As Gustaf showed earlier, despite continued supply challenges, our revenue grew by 3% organically in the quarter. Geographically, revenue in Americas grew by healthy 7%, with solid sales in the US and strong sales in Canada. Our operations in EMEA grew slightly by 2%, positively impacted by higher installations in Italy and Spain. In APAC, revenues were in line with previous year with continued good growth in China despite local shutdowns. Our adjusted gross margin improved in the quarter, both sequentially and year-over-year. Expenses grew year-over-year but declined sequentially. Finally, while FX had a positive impact on a gross margin level, exchange rates, hedges had an adverse impact of 420 basis points on our operating margin. All in all, our adjusted EBIT margin declined by 270 basis points year-over-year.

So let's turn slide and look into our gross margin development in more detail. Our adjusted gross margin increased by 180 basis points year-over-year. This improvement is explained by the following. Just as I mentioned, we had higher revenues, which contributed positively by 120 basis points. We had an improved mix both from selling relatively more service than solutions as well as some positive product mix. This effect contributed positively by 250 basis points. FX had a positive impact on gross margin level of 110 basis points, mainly driven by the strengthening of the US dollar. These were partly offset by higher supply chain costs and inflation which had an adverse impact in the quarter of 300 basis points.

Now let's turn slide and talk about our expenses in the quarter. Selling expenses increased by 14% in the first quarter. This was driven by more market and customer-facing activities, such as the ESTRO, AAPM and the MR-Linac Consortium, and generally easing of restrictions for traveling and exhibitions compared to a year ago. Our administrative expenses increased year-over-year, but declined sequentially.

Net R&D decreased year-over-year, capitalization was higher since more projects have moved to capitalization phases, while amortizations declined year-over-year. Sequentially, net R&D increased following the increase on gross R&D. All in all, expenses grew by 3% year-over-year in constant exchange rates. So, let's look into our R&D development in more detail. In line with our plan, gross R&D increased in the quarter in order to strengthen our innovation pipeline. In the coming quarter, gross R&D expected to stabilize and then come down as a consequence of our planned spend reductions. Capitalizations increased compared to last year but was stable sequentially.

So now, let's turn slide and look into our net working capital development. Our net working capital continue to follow a normal seasonal pattern. As a percent of sales, it amounted to minus 4% in the quarter, which is the same level as Q1 in the previous years. During the quarter, we built some more inventory to secure future installations under the current extended lead times within the supply chain.

So, let's turn slide and talk about our cash flows. EBITDA amounted to SEK 379 million in the quarter. Following the buildup of working capital in the quarter, cash flow from operating activities amounted to approximately SEK 200 million negative, resulting in operational cash conversion of 6% to 7% on a rolling 12 months basis. Our continuous investments amounted to almost SEK 400 million, mainly driven by investments in our innovation pipeline and a strengthening [ph] our (00:12:48) product offering. All in all, our cash flow after continuous investment was about SEK 600 million negative.

Now, let's turn slide and look into the details of our cost reduction initiative. So, as Gustaf mentioned, we have now launched a cost reduction initiative within the Resilience and Excellence Program, which includes measures to drive synergies and enhance productivity across the organization. This initiative is estimated to lower our annual [ph] gross (00:13:20) spend by SEK 450 million when fully implemented. Out of the SEK 450 million, one-third will come from COGS reductions, SEK 200 million from optimizing R&D spend, and SEK 100 million from lowering selling and admin expenses. About half of the lower R&D spend will contribute to higher earnings in our P&L and half will reduce the investments building up in the balance sheet.

By the end of this fiscal year, we estimate to reach a spend reduction of approximately SEK 200 million from the initiative. Since the initiative is just starting, the savings are still to come in the following quarters. For the convenience of measuring the underlying performance, we define nonrecurring costs for realizing the spend reductions as items affecting comparability. In total, we estimate these costs to amount to approximately SEK 400 million. In the first quarter, implementation cost amounted to SEK 14 million.

Over to your, Gustaf.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

Thank you, Tobias, for that. And now, I would like to take a bit the outlook view on Q2. And we continue during the quarter to see uncertain macroeconomic environment and supply chain challenges, and it will continue to impact our installations, costs and margins. If we look at the installation volumes, we expect them to be in line with Q2 last year. And as always, I would like to reiterate that in the long-term perspective, we see the market trends supporting growth and investments in high-end radiotherapy equipment and a margin expansion.

And if you take the midterm outlook perspective until 2024/2025, we see that as unchanged. So we're driving for net sales over 7% of CAGR over the period and we should see EBIT margin expansion over the period, and we also have a dividend policies of more than 50% of annual net income. And at today's AGM, the Board of Directors proposes a dividend payout that corresponds to 79% of the net income for the fiscal year.

So let me now summarize Q1. We continued on our path to revenue – on revenue growth, and we also saw a strong order intake in two of our regions, EMEA and APAC. We increased our market activities and continued with higher supply chain costs and inflation that impacted margins. We initiated a cost reduction initiative and it's launched to expand our margins and support profitable growth. We are reiterating our outlook to 2024/2025, and we continue to deliver on ACCESS 2025.

So with that, I hand it over to you, Cecilia. Thank you.

Cecilia Ketels

Head-Investor Relations, Elekta AB

Thanks, Gustaf. Then, we open up the lines for your questions. Please, operator, over to you.

QUESTION AND ANSWER SECTION

Operator: Will now begin the question-and-answer session. [Operator Instructions] First question is from Erik Cassel from ABG. Please go ahead.

Erik Cassel

Analyst, ABG Sundal Collier AB

Q

Hi. Good morning, everyone. So my first question, it seem as if everyone have talked about good momentum in the US on orders and that they're not seeing demand go down. I've seen this from [ph] Aker and Phillips (00:16:59) as well. So I'm just wondering why is this happening to you and not for them?

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Yes. Thank you. I'll take that question. So if you look at the Q1 orders, we have had a quite difficult comparison to two last years, so very large deals – some of the largest deals ever for Elekta in the US and Americas market. But underneath, we also experienced a bit of a slower market. Going forward, we will have a better outlook and we see the sales funnel building up in the region. So, I'm more positive looking ahead. I think for the competitors' numbers, I think that's not something I should reflect, [ph] I'd say (00:17:47), but we see a good trend going forward in our sales funnel.

Tobias Hägglöv

Chief Financial Officer, Elekta AB

A

And I can also add on to that, that actually if you expand the horizon a little bit and look over the last quarter, it's not just a single quarter, we have had consecutive period here with order growth. So, that is also worthwhile to mentioning when looking at the order development for Elekta.

Erik Cassel

Analyst, ABG Sundal Collier AB

Q

Okay. But did you see any differences in tender activities, say, going into July, for example, where it slowed down significantly or was this throughout the quarter?

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

As we see it on the order side, it's been throughout the quarter. It's been a bit slowdown of activity and we expect it to pick up going forward.

Erik Cassel
Analyst, ABG Sundal Collier AB

Q

Okay. Thank you very much. And then, I appreciate you guiding for installation volumes, and I guess that's on unit volumes and not sales. So, if so, could you help us further with expecting pricing effects on solution sales? And then also if you assume any mix effect towards, say, Harmony, Unity, and Gamma Knife sales?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yeah. No. Great question, of course. So if we start with installations, yes, that's volume. But it's just to give a bit of flavor what we see into next quarter. So that's our device volume. Then, of course, you have 40% of the service revenue, and that's recurring revenue, the majority of it. So I think that's easier also to predict a bit how that should be developing. That's usually growing. And then if you take the price question, we have been working hard over the last two, three quarters since we've seen the inflation dramatically increase to reflect that in our pricing. But as I usually see, we see a delta of a year between order to revenue on average. So, I think that's important to say. And I also usually say that the key thing to increase price is to bring new value to the customer, and that you do through product releases. And we have released a lot of products throughout the last years. We have, of course, Harmony. We have Elekta Esprit now, and we have the Elekta Studio [ph] on the brachytherapy (00:20:01) side, and we have also new software launches both on our treatment planning software and oncology information software.

So, I think that's the key thing to increase margins and that we have done or – both margins and price, but that's what we've done throughout the last year here. So, we're driving for price increasing. Absolutely. It's very high up on our agenda due to the current situation out there, and we also see that we have a good customer acceptance for that situation.

Erik Cassel
Analyst, ABG Sundal Collier AB

Q

Okay. Thank you very much, Gustaf. I'll limit myself to those questions and come back later if there's time. Thanks very much.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Thank you.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Thank you.

Operator: The next question comes from Kristofer Liljeberg from Carnegie. Please go ahead.

Kristofer Liljeberg-Svensson
Analyst, Carnegie Investment Bank AB

Q

Yes. Thank you. A few questions related to the cost savings program, if you could expand a little bit more how it will be achieved. Is it about mainly lowering the number of head counts or are you also cutting back on some of the R&D projects you have talked about before, thus it relates to purchasing, etcetera? And based on this, I wonder what the risks for achieving these savings and whether you would say there's a low or high risk for the timing [ph] for achieve (00:21:25) these savings? Thank you.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Thank you, Kristofer. Yeah, I think the starting point is what Tobias showed in his view on the COGS and OpEx savings. So, if we start and look at the OpEx savings, it's quite difficult at the moment to work a lot with procurement and savings for negotiations and so on because of the component shortages and so on. It's still a sellers market. We see that the index is going down and so on, but that's not really what we factored into the saving. It is primarily by efficiency in our operations. By combining, as you maybe have seen, two of our business lines, that was the Business Line Linac and MR-Linac. And you can get the efficiencies out from that combination.

So that's a couple of key areas. And we've also worked with a service organization to drive more efficiencies throughout that organization. And that is also part of the COGS and the gross margin. So, to your question, it's primarily a personnel related but it's supported by reorganizations to support that, that we have initiated earlier in quarters here.

If we look at the OpEx side, and we start with the innovation side, it's been a lot about accelerating innovation, as you know, over the last two, three years. And we have invested heavily in our new Linac platforms, in the Unity platforms and software development. And I think as we mentioned last year, we have come up to high level and it should decrease going forward. So, we have formed a joint product organization under Maurits Wolleswinkel that some of you met at ESTRO and he's now driving synergies and efficiencies around that organization and also speeding up how we should deliver on our product pipeline going forward. So, those savings is also about prioritizing projects to absolutely focus on the projects that we should deliver in the next years here, but it's also personnel related.

On the admin, sales and marketing side, or if we say SG&A is really about continuing with the fantastic shared service centers we have in, for example, Warsaw, and we have a good foundation to continue to drive efficiencies in optimization, in digitalization of our processes, and thereby reducing cost and that will also be primarily personnel related as well. And since that's the effect, then you will see a faster rollout and execution of those cost savings because that's what we need to do right now. We need to act on a cost base that's in our control because of the margin pressures we're experiencing, and that's what we're executing on right now. And then going forward, when we see supply chain cost improving and so on, some of these benefits will then continue to flow through in those coming if it's quarters and years. So that's the plan and that's the ambition going forward, to come back to the journey to profitable growth.

Kristofer Liljeberg-Svensson
Analyst, Carnegie Investment Bank AB

Q

Could I follow-up with two additional [ph] themes (00:24:39)? First, on the US or North American orders seems now you're back at this more historical trend of around SEK 1 billion in North American orders in Q1. And if so is the case and based on the previous question, it seems you haven't seen any rather large new negative impact in North America. Does this mean we could expect the group order growth to return now in the second quarter?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yes, we see – we have a better outlook. That's – and I focus a lot on the sales funnel and a buildup of the sales funnels because that's the leading indicator what the orders will become, and I think we see positive signals there.

And as I mentioned before as well, we have a much broader product portfolio with many recent launches now to address the US market. Then we get great feedback in the meetings we have there. And we have ESTRO conference, that's very important, coming up here in October. So, we are focused on it.

And at the same time, the US market is a bit more cautious is still my view on the discussions we take. It takes a bit longer. It is about the macroeconomic factors as well and it's also about when we talk about the installations and that sometimes impacts the orders discussions. It take a bit longer and more difficult to get hold of all the things you need to do to install the linacs also on the customer side. But we will see a gradual improvement there. And if you look into the other regions, we see really good sales funnel build up for the second quarter and going forward as well.

Kristofer Liljeberg-Svensson
Analyst, Carnegie Investment Bank AB

Q

And finally, on the gross margin, of course, helps a lot about the product mix and the higher proportion of service in the quarter. But at the same time, you're talking about some positive signs when it comes to freight cost. You have the cost saving program, etcetera. So, how would you describe the possibility to now to not having to see the gross margin coming down to the [ph] 47% (00:26:53) level again in the next few quarters?

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

No. I think as you stated there, Kristofer, this is the difference in this quarter that it is an improved gross margin and it's actually improving here with 180 basis points. And that is quite different compared to previous quarters. I think when we look upon the gross margin development ahead, I talked about the growth characteristics. We do have a continued pressure here from a supply chain cost and inflation, but, fundamentally, Gustaf talked about, I would actually divide it a little bit into next quarter and then expand the horizon. If you just look at the next quarter, we had a very positive mix in Q1, which is worthwhile to remember. But, fundamentally, when you look at growth potential, we look at the, so to say, our own ability to drive price and mix mid to long term. We are confident in long term. But consider some of the headwinds here when we look into the next specific quarter.

Kristofer Liljeberg-Svensson
Analyst, Carnegie Investment Bank AB

Q

Great. Thank you very much.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Thank you.

Operator: Next question from – comes from Victor Forssell from Nordea. Please go ahead.

Victor Forssell
Analyst, Nordea Bank ABP

Q

Yeah, thanks a lot. Starting on net sales, please, and installations you highlighted to be quite flattish in Q2. That's appreciated. But also some difficult conditions with push forward installation dates, etcetera. So, could you please spend some more time on those factors? What is hindering you from delivering on a global scale compared to previously perhaps? And also, if you could address MR-Linac situation, if you think increased installations year-over-year will be particularly difficult for this product line and a little bit more discussion around installations, please?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yes, absolutely. I'm happy to go through a bit of the dynamics on the installation side. So, there's a couple of different factors. And I think you need to divide it into kind of supply and demand. So, we as a supplier, we haven't stopped our production lines. We are producing. It's more difficult to get hold of the components as you know, especially the chips that we have quite a few [ph] on our (00:29:40) linacs, but we have managed that. But it takes longer and it's more expensive. But we ship out the linacs from them – from Crawley and from Beijing and our brachytherapy afterloaders and applicators from Veenendaal and so on. So we're shipping out. But then the shipment takes also longer because of port congestions and difficult supply chain.

And then when you start the installation, then it's a bit more difficult to plan because it's a longer time perspective, but the customer also needs to be ready. And the customers sometimes have had challenges to get hold of all the components, equipments they need to have on their side to start the installation. So, this is something, of course, we project, manage and work with every day, but it's not a steady state situation yet. So, if you would highlight the countries where it's maybe more challenging, it could be in emerging markets because it takes longer. It has been in China because there were lockdowns. But that's improving now. And we had actually quite good revenue growth in a quarter in China because we installed software and Unity and so on.

So, that's the dynamic market by market that we're working with each and every day. And I think what makes me a bit more positive, if you look maybe not the next quarter but two, three quarters out, is that you start to see all of these indexes that I guess all of you followed as well with sea freight index, this port congestion index and so on to improve. We haven't seen those effects spilling over to us yet, but I expect that to come in a not too distant future. But I'm not saying [indiscernible] (00:31:23) in the Q2.

Sorry, what was your second question, Victor? Sorry.

Victor Forssell
Analyst, Nordea Bank ABP

Q

I was tying it to the MR-Linacs [indiscernible] (00:31:33).

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yes, yes. So, MR-Linacs, I think we see an improving situation there. We haven't had any major supply chain issues, anything like that on the MR-Linac side. But it's been this discussion throughout the COVID times that we need more local teams to do it, to not be dependent on the central teams. And that's also something we've done in the resilience program to add the local capacity in, for example, China, for them to be able to install MR-Linacs, but it could also be the Leksell Gamma Knife. And that does happened now. So, we're in a better place there to have local installation resources doing it. So, we drive for high volumes, absolutely, and we have the organization to take care of it.

Victor Forssell
Analyst, Nordea Bank ABP

Q

Thanks a lot, Gustaf. And if we move back to the last quarter, you seemed quite confident in having this operating leverage throughout the quarters ahead, perhaps not in Q1 though. Now, it sounds as if this cost reduction program that you sort of accelerate here today, just curious to hear what the magnitude of the cost increases are. If you could just go from the largest to the smaller one and what has really pushed you into accelerate this reduction program, please?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yeah. I can start and then Tobias can talk more about when and how and so on. But the starting point for me, Victor, was really we have seen these logistics costs continue for longer than we expected. If you'd asked me, three, four quarters ago, we've seen the pressure on margins and so on. And for us, we need to then address what we can address and that's our cost base. And we worked hard these initiatives I mentioned, on the engineering organization, operational organization, but also shared service setups. So I think now is a good time to drive those efficiencies.

And it is really about to do what we say, to come back to profitable growth that we haven't been showing the last quarters. So that's the background to it. And the resilience program has been excellent to be able to continue to install and service. But now is the time to also reduce cost base and come back to EBIT margin where Elekta should be. And we see a nice – we see what we can do on a gross margin in a good quarter. And then, we're waiting for some of those negative effects on the supply chain costs to go away, but we cannot just sit and wait for that. We need to address our own cost base in the situation we're in. And I think this will be positive for Elekta going forward if you take a bit longer perspective on our cost base and our margin expansion. So that's the background and that's the plan.

But I'll let Tobias kind of ask when it comes and in what periods and so on, if you want to give some flavor.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Yeah. Absolutely. I can...

Victor Forssell
Analyst, Nordea Bank ABP

Q

I think and also, Tobias, the facing here, how it looks through the savings you aim for in this year and into next, and if those are gross or net impact, please?

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Yes. Right. So I'll start with your first question there, Victor, right, okay, what is the impact to Elekta and I think you've seen over the quarters here that we have reported a quite massive headwinds here coming in from a higher supply chain cost and we have seen an acceleration on the inflation, etcetera. I think Elekta is a great company and we've been building, strengthening the company here for the last years as well with the good reasons. And what we actually are doing now is we take the responsibility. We make sure that we have [indiscernible] (00:35:20) which align on sales and cost and – which we need to do as a company. We are committed to deliver shareholder value and we will do so going forward.

And when we look in terms of the specifics of the program here and, okay, how does this play out, you will see that in terms of these costs that we talk about, that the majority of these costs and thereby also the activities will be taken in this year. The majority of that within this year will be taken in the two coming quarters. So we will not sit here and wait, we will take actions, but do this in a proper and responsible manner.

In terms of the savings here, you saw on a slide that we have, spend reduction of SEK 200 million year-over-year in this year. The majority of that year-over-year impact, because you have a gradual impact, will likely to be seen here in the second half. When you look at then the, sort of, what I was talking about is that when you're modeling this and you have the COGS reduction and the efficiency in selling and admin functions, that is purely directly into the P&L. When you have optimized the innovation pipeline, a bit more than half of that will actually reduce our investments, while a little bit less than half will then impact directly into the P&L. So that is a little bit how it plays out.

You see that in the first quarter we had items affecting comparability amounting to SEK 14 million. And since the actions that we have taken out during Q1 was skewed towards the end of the quarter, the savings is not so large here in Q1 in terms of year-over-year. But this is just the – I think it's a national step. We manage the sales and cost execution ahead of us and I think we have all reasons to think why this can't continue on a continuous successful journey for Elekta.

Victor Forssell
Analyst, Nordea Bank ABP

Q

Thanks a lot.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Thank you.

Operator: Your next question is from Veronika Dubajova from Citi. Please go ahead. Thank you.

Veronika Dubajova
Analyst, Citi

Q

Hi, guys. Good morning and thank you for taking my questions. I'm just going to return to a couple of the [ph] themes (00:38:04), if that's all right. And one, just kind of circling back to the competitive dynamics that you're seeing. And obviously, we've – I appreciate this quarter had a pretty tough comp for you in the Americas business. But if I take sort of a longer view of our two to four quarters, I think Healthineers have discussed double-digit order growth that they've seen with a fair degree of consistency through that period; whereas, for you, the order momentum has been much weaker.

And I'm just curious, Gustaf, is there anything within the organization you think that explains that dynamic? Does it come down to price? Does it come down to your positioning in terms of the product portfolio there? Is there anything that you think you can do looking forward to kind of accelerate that momentum? I appreciate you don't control the market, but even if we kind of take it as market is what it is, it does seem to me that you are underperforming the Healthineers by pretty significant amount. So, I'd love to kind of get your thoughts on that. And then I'll ask my second question after that, if that's all right.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

And it's the full question. Hi, Veronika, by the way, welcome back. But the question, is that the linked to US, your question?

Veronika Dubajova
Analyst, Citi

Q

Yeah, yeah. I think US, but also I think more broadly if I look even at the global numbers, I think you are underperforming [indiscernible] (00:39:31) and some of that might be geography, but I'm just kind of curious what you're seeing on the ground, because from where we sit, all we see is a public number. So, it does seem to me certainly that there is a gap from a competitive perspective...

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yeah. And...

Veronika Dubajova
Analyst, Citi

Q

...in US in particular, but also globally.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

No. I'm happy to break that question down and give some perspective from my side. And I agree, it's quite difficult to see how they grow by region nowadays when they're kind of part of Siemens and Healthineers. So, it's difficult to do the comparison you're referring to. But if you take the US perspective, the market has been a bit slower for us after two great quarters. As Kristofer said before, we're back to more to a – I don't say it's a good quarter, but it's kind of more to normal levels and that we should grow from, but we had two years of very strong Q1s. So, that's the starting point.

And as I mentioned, I see great growth opportunity for Elekta if we start with the US market. I see the product portfolio is broader. And also we shouldn't forget either that we have very strong partnerships now to leverage and work with and be part of with GE and with Philips. Philips more on the product side and a preferred partnership there, and GE really on the commercial side, driving that forward. So, we start to see interesting opportunities coming out from that as well on the oncology side. And of course, you need to translate that into order and so on. That's what we're working a lot with that at the moment.

If you look at market shares and how we see market share, we see that overall globally throughout the year, we have been flat to taking some market shares is what data is telling us, globally. And I think that's also an indication that we have a very strong offering and been able to grow in many our markets. And I'm also looking at the European or EMEA markets as well as APAC. We show strong numbers. And we also expect many of those markets to pick up in the second quarters when it come to orders, especially I would maybe highlight China, that's been in quite a tough spot for a few quarters.

Elekta, as you also know, always very strong in emerging markets. And I think we showed that in the report with a fantastic order to Nigeria really bringing our best products or most advanced products to Africa and Nigeria. So, I think we are driving a good order situation, but, of course, we need to improve the numbers in the US in the quarter. And you can also see that from the report and our announcement that we have a new Head of Region Americas, Carlos Castilleja, that will drive the region going forward as well.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

And maybe also to add, Veronika, I think it's a good question. But also to state here, I think it's – look at the last years here, we have two quarters. I had to go back in time with the negative. The rest are positive. So, I think we have seen a quite stable and consistent order growth here. We have now one quarter, but we have communicated confidence ahead of us in terms of the orders. And I think we have gained momentum from some events, acquisitions in the market. And, so our view on the competitive landscape is that we are confident about this development, and we will continue to have a solid and strong order development ahead of us.

Veronika Dubajova
Analyst, Citi

Q

Okay. That's very helpful. And my second question is sort of – it might sound a little counterintuitive, but I think, Gustaf, I asked you this a couple of quarters ago before I took some time off. And if I look sort of, obviously, the backlog is at an all-time high. You've now been in a situation for a number of years where your installation pace has been flat. And I'm just kind of curious, obviously, you're cutting costs, you're reducing the size of the organization, yet you have this really significant backlog that, assuming the world goes back to normal, you should be able to start executing on.

And I'm just curious what your thoughts are if they have changed at all about how you can deliver that SEK 40 billion backlog, how quickly you can translate that into revenues? Are you making any investments in order to do so, or, sort of, now the focus is on cost reduction and the backlog will transform into revenues over time as you go at a similar pace?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

No, it's a great question, Veronika, and something we planned for and discussed and drive a lot in our supply chain organization. So, if you look at where Elekta have added a lot of people during the last years, so there's been a significant increase in head count that has been in partly to service and order fulfillment, as we call it, organization, as well as in the R&D organization to support those strategic pillars in customer companion on the service side and accelerating innovation on the R&D side. So, what we have done with those resource as well is to build up new processes and so on. But many of them are now dealing with all of these challenges in the logistics supply chain. So it takes more time for them just to deal with all the turbulence and longer lead times and so on. So that's very time consuming.

When we see that, that will release, I also expect to get those efficiencies and we will get more kind of installations per order fulfillment [ph] held (00:45:45) and so on because the times will reduce and the supply chains will not be as stressed. So, I expect a good order backlog to revenue conversions, and that's not just in this year, it's also into next year from, I agree, the fantastic and very large order backlog we have. And I think the speeding up of that order to revenue transformation is not as you hear in Q2 because we are telling that the installations will be on similar levels, but the second half and onward.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

And just adding to that. I don't think it's either or in terms of sales and costs, but this is actually the reduction initiatives is to take responsibility of then – one part but just to – what you mentioned here that sales execution is something that we will never lose focus on. So, it's not about to trade off in between those two.

Veronika Dubajova
Analyst, Citi

Q

Okay. That's helpful. And would you – Gustaf, I guess, you're – you sound more optimistic about [indiscernible] (00:46:55). We are a quarter away from that? Two quarters away from that? Three quarters away from that? What's your best guess at this stage?

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

You shouldn't guess, should you? But for me, I think it's difficult to say during the current circumstances with the supply chains. And I've got this exactly same questions you asked now, Veronika, a year ago or maybe three quarters ago, and then we expected that improvement to come earlier than it did, and then you had a war in Ukraine and so on. But all things equal, if I may take that assumption, I think it's not Q2 too but it's more in the second half of the year. But, of course, it could happen unforeseen events and so on in the coming quarters impacting that.

Veronika Dubajova

Analyst, Citi

Q

Okay. That's helpful. Thanks, guys.

Tobias Hägglöv

Chief Financial Officer, Elekta AB

A

Thank you.

Operator: Your next question comes from Rickard Anderkrans from Handelsbanken. Please go ahead.

Rickard Anderkrans

Analyst, Svenska Handelsbanken AB

Q

Hi. And thank you for taking my questions. So first one, you mentioned in the report some pushout or delays of installations here, China, but in other markets as well, as I understand. Could you quantify that anyhow and provide any flavor on when we should expect sort of the incremental contribution from these pushouts to be phased in, in the coming quarters?

Tobias Hägglöv

Chief Financial Officer, Elekta AB

A

Yeah. So, good question. As you know, when we talked and I also can add on here to Veronika's question, China is one example to say. We had – in the quarter, we had double-digit growth in China despite the local shutdowns that were evident, and the quantification of that is mid-single-digit in terms of if we – it's sometimes a little bit crazy. But there was a clear impact on this. But our position, it's a healthy, growing market and we have a very strong position in the Chinese market. And that is one part of actually why we have confidence when we look and expand the horizon a little bit and looking for sales development mid to long term.

Rickard Anderkrans

Analyst, Svenska Handelsbanken AB

Q

Okay. But should we expect most of these pushouts to be recovered in next quarter?

Tobias Hägglöv

Chief Financial Officer, Elekta AB

A

I think what we have said here in terms of the – you have read this, we say that installation on the [ph] solution sign are (00:49:36) roughly in line here with the last years and the development for the service is a bit smoother. And that add on then a few percentage of growth.

Rickard Anderkrans
Analyst, Svenska Handelsbanken AB

Q

All right. Great. And final one for me. You mentioned the tenders in Europe and we know, you have quite large ones in Italy and Spain, for example. And as I understand, you have been a preferred partner or a player based on price since a little while back. How are you feeling now given increased inflation in terms of the margin profile of this sort of tender process and the positioning?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

I think we are honored and very positive that we have been selected as one of the, obviously, preferred parties for both [ph] these deal (00:50:32) and in Spain and Italy. And it looks good what we are able to get [ph] out of the (00:50:38) deals and what we are now booking as orders as you see in the quarter for Spain, for example. Italy is a bit further out. So I think that's important.

And then if you think about the [indiscernible] (00:50:51) profitability of these deals, it's very important to have this installed base because this was something that will go on for 5, 10 years with service revenues and upgrade opportunities and so on. So we are extremely pleased to be a strong provider to both Spain and Italy and the regions when it comes to this area. And I think there's good opportunities to get good margins from it as well.

Rickard Anderkrans
Analyst, Svenska Handelsbanken AB

Q

Okay. So – but perhaps a bit lower margin sort of upfront or on the sort of hardware side, but perhaps making that up over time through service software, etcetera or how should we think about it?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yeah. I think that's – yes, I think that's a good assumption. So – because it is really – you are a companion to the customer over 10, 15, 20 years when it comes to [ph] these things (00:51:48), and we're taking a bigger share of this deal compared to our current market share in this area, and that enables a lot of opportunities. Pricing wise, as usual, if you have these very, very large orders, we're talking 80 units per country, then that often impacts the price a bit. So, that's quite natural. But then, over time, you work with bringing more value to that installed base, and then the margins and profitability come with it.

Rickard Anderkrans
Analyst, Svenska Handelsbanken AB

Q

Great. Thank you.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Thank you.

Operator: The next question comes from David Adlington from JPMorgan. Please go ahead.

David Adlington
Analyst, JPMorgan Securities Plc

Q

Hey, guys. Thanks for the questions. So, firstly, just on order growth, it might be easy if we just sort of strip out the Americas office given the comp. But if you think about the 10% in [indiscernible] (00:52:41) EMEA and APAC, I just wonder how much of that was down to price? Obviously, you just talked about improving pricing. And then second, just in terms of nearer term, sorry, but just in terms about Q2 installations being flat. Obviously, costs are going to continue to be higher. Should we still be thinking about a single-digit margin in the second quarter? Thanks.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

So, if I look at the order – gross order intake and the price impact of it, there is many, many different factors, of course, David, on – with service. And we have different product mixes and so on. But it's not that we saw a big price increase driving that growth. We see the prices coming a bit later. But we had, for example, a good Harmony quarter and that's very positive because that product has a relatively higher margin compared to the products it's kind of replacing. So that was more technology launch effect on the pricing in some of these regions. And I think that's very positive. So, primarily, the volume of the orders at the same price level and that gives us an addition opportunity to raise price and also drive growth going forward here in those regions but also in the Americas.

And so, your second question, David, that was around?

David Adlington
Analyst, JPMorgan Securities Plc

Q

EBIT margin in the second quarter, should we still be expecting a single-digit margin?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yeah. We don't really guide on the next quarter on that level. But what we have said is that continued high supply chain costs, installations at the similar level as last year, service growing. And then, when you also think about the cost reduction program, we'll see some but not that big effects in the Q2. And then, I think you should factor in a bit that we had a very strong product mix in the Q1 and we don't see that really coming in, in the same way in the second quarter. So I think that's the key components we can talk around when it comes to the outlook for the second quarter. And then, as I also mentioned, sales funnels are building up and we are positive on the growth outlook for orders in the second quarter.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Absolutely. So, I think those are very good points. And just to talk about the gross margin impact there and – recall, the positive mix that we had year-over-year in this quarter. Then below the gross margin, as Gustaf mentioned, yes, now gradually here from where we are now to look in sequential improvement on selling on admin cost. And also then, in addition that, the net R&D also to be a little bit lower, not so much that will remain pretty stable out of the outcome here, but so those are some of the high level points to add on that.

David Adlington
Analyst, JPMorgan Securities Plc

Q

Great. That's helpful. Thank you.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Thank you.

Operator: We have a follow-up question from Erik Cassel from ABG. Please go ahead.

Erik Cassel
Analyst, ABG Sundal Collier AB

Q

Hello, again. So I was just thinking about the quality of the order backlog that has continued to [ph] serve us well (00:56:16). And there's two parts to this question. First, how much of the order book is now older than 30 months? And then, how much is in economies that's now sort of struggling, for example, Turkey or South America, let's call it emerging markets, which may not be able to be converted into sales?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yeah. The order backlog, well, I don't have the exact number of over 30 months. But if you look at our order booking criteria, we book solutions three-year contracts and service five-year contract. So that's the order booking criterias. If you look at where it will be going out, we've seen good order backlog conversion into emerging markets as well. In Africas, we mentioned in Middle East, many of these countries are also having a good impact from the oil price developments. We shouldn't forget about that.

And then China is a different dynamic. China has been in the lockdown situation right now, but they have a very ambitious plan to increase cancer care and radiotherapy in the years to come. Part of that we have in our order backlog, and I foresee that development and installations to go well going forward. Turkey, it's a good and important market for us. We have been successfully driving installations in Turkey during the last quarters as well.

Erik Cassel
Analyst, ABG Sundal Collier AB

Q

So, you're not really seeing any risks of order cancellations from emerging markets or any risks to receivables either? Is that what you think?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

There's always risks, you should say that. And we are mitigating that and we have robust processes to look into our collections and cash flow, and I would say the cash-in coming from the regions. We're seeing very good development there in our cash flow. And that's something I look a lot just to get the feeling for payment structures and so on. I think it's more about the cash out that weakens the cash flow, and that's linked to the inventory. So, I don't see any big risk for the order cancellations from the regions, and it's something we monitor every quarter just to understand that risk that you're mentioning. But I don't see a heightening risk during this quarter, the last couple of quarters there.

Erik Cassel
Analyst, ABG Sundal Collier AB

Q

Okay. That's good to hear. That's all for me. Thank you very much.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Thank you, Erik.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Thank you.

Operator: There are no more questions at this time.

Cecilia Ketels

Head-Investor Relations, Elekta AB

Okay. And we came to the end of the hour. I want to thank all of you who participated and listened in to our call today. And if you have further questions, please don't hesitate to reach out to either myself, IR, or our CFO, during the day. Well, thank you so much and have a good remaining day.

Tobias Hägglöv

Chief Financial Officer, Elekta AB

Thank you.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

Thank you.