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Elektá AB (EKTAY.SE)

Q1 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Cecilia Ketels

Head-Investor Relations, Elekta AB

Good morning, everyone, and warm welcome to the presentation of Elekta's First Quarter in the new Fiscal Year 2021/2022. 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, Johan Adebäck, who will be presenting the results.

And today's agenda start off by Gustaf presenting some of the highlights of our development, then Johan will give you details on the financials. And the presentation ends with Gustaf's view on Elekta's outlook. 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 on this call contain forward-looking statements. This can include projections regarding revenue, EBIT, cash flow, as well as products and product development. And this statement involves risks and uncertainties that may cause actual results 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 good morning to everyone on the call.

I will, of course, present the highlights from the quarter, but I would really first like to start with our strategy that we launched at the Capital Markets Day in early June. It's ACCESS 2025. And it's really focused on driving towards a

world where everyone has access to the best cancer care. And the strategy has been very, very well received from both external and internal stakeholders, and we're currently working with the strategy execution.

But the strategy is really built on four key pillars. It is about accelerating innovation with customer utilization in mind. It's also about partnerships. Partnerships is and will always be very important for Elekta. And it's about integration across the cancer care ecosystem. We are and we will always be focused on being the companion for the customer throughout the lifetime. And a big and vital component of ACCESS 2025 is, of course, to drive the adoption of cancer care and radiation therapy across the globe.

This strategy is supported of all our fantastic people in Elekta. And we also have a lot of resilience and process excellence initiative currently and it's really also speeded up by all the measures we've put in place throughout the COVID pandemic. And as the basis for all of this, all of it needs to be delivered in a sustainable way. And I'll come back to that.

But if we now drill into the quarter and the highlights in Q1, we mentioned at our Capital Markets Day that we announced and strengthened partnership with Philips to develop solutions that would streamline the path from cancer diagnosis all the way to survivorship and thereby also resulting in better patient outcomes. The partnership is progressing really, really well with strong collaboration and promising initiatives and solutions being developed.

From a product perspective, we experienced good progress in US. Firstly, received FDA clearance for our newest linac, Harmony, and we also received the largest order ever for brachytherapy solutions. We received a patent for our unique IntelliMax service solution and we also saw 36 abstracts based on Unity that was presented at AAPM. We went direct in Indonesia to drive adoption.

And in terms of the financial performance, we experienced improved market demand. It was very big geographic and country variations and also saw installation volumes to continue to recover and increase. At the same time, we are experiencing temporary but strong and unexpected headwinds to our gross margins due to increased supply chain costs, logistic costs, service costs. And we also see negative currency impact and we'll cover this in much more detail later in the presentation. We are continuing to accelerating our innovation investments into new platforms, but also big focus on software solutions.

If we then look into the market, it continued to recover with stronger demand and better access to customers, particularly in more mature markets. And in the quarter, if you adjust for the biggest deal ever in the US last year, the underlying growth was 17% and the reported total growth was minus 4%. As mentioned, the order situation was very mixed between markets and countries. But we saw a lot of demand in China, India and Europe and they are the countries and regions that stands out as the key growth drivers in the quarter.

I mentioned our recovery as kind of an extended U from COVID previously. And you can see here that our installation volumes increased significantly compared to the first quarter last year. And we also saw solutions revenue, based on our products and installation, growing faster than service. The overall revenue came in at 8% in the first quarter and we've seen very resilient revenues throughout the pandemic. And this is actually the fourth consecutive quarter with revenue growth. And to the right, you can see the installed base growth and it continues to grow. And in the quarter compared to last year, our installed base has grown with 6%.

As part of our adoption strategy linked to ACCESS 2025, we went direct in Indonesia. It's, of course, a huge country, huge population and they only have a installed base of 80 linacs. And we believe that by going direct in this market, we will continue to support adoption and drive customer service, and also order growth going forward. And Indonesia is a market where Elekta has a very strong position and market leadership.

And then back to sustainability and we always see our strategic agenda to be deeply linked with our sustainability agenda initiatives. And, going forward, we will see the two really linked together. And when we are driving our initiatives, we are convinced that sustainability needs to be part of all our evaluation of initiatives on the innovation side, on the resilience side. And that's something we have put in place in all our initiatives and our objectives.

ACCESS 2025 is linked and supported by sustainability agenda, and we're adding ESG initiatives and targets across the company on all levels. We are committed to the Paris Agreement and Science Based Targets. And we also set ambitious strategic milestones that until 2024/2025, 300 million people in underserved markets will get access via Elekta installed linac base.

In the quarter we saw a strong development in relation to our sustainability targets. Since Q4 2019/2020, we have seen the linac installed base has increased by 12% in underserved markets. And during Q1 this year, an additional 20 million people got access to radiation therapy.

And now to Unity. So, our growth journey with Unity is progressing very well, and we continue to see increasing demand and accelerated installations. Our customers are generating robust data and its driving evidence-based decision-making, but also reimbursement discussions. Our focus has been now generating evidence for Unity. And as we have shared before, our main initiatives, for this is the Consortium, collaboration between 58 medical centers using Unity and of course the MOMENTUM study.

At ESTRO, we currently have 72 papers from Unity users. And, in summary, we're currently focusing on building a strong evidence base for the clinical value of Unity. And since our last update, we have also seen an important milestones and steps being made in reimbursement submissions, notably by JASTRO in Japan and ASTRO in the US.

So, with that, I would like to hand it over to Johan.

Johan Adebäck

Chief Financial Officer, Elekta AB

Thank you, Gustaf.

I will now go through the financials starting with net sales and EBIT margin development. Total net sales grew 8% with solutions sales increasing a strong 12% and service up 3%. Solutions sales grew in all business lines except Brachy. Service sales grew at a relatively low pace against a strong comparison quarter. As a result of a strong Solutions sales, solutions was 54% and service 46% of sales. Our EBIT margin came in at 6.7% for the quarter, down from 11.2% in Q1 last year. And I will go through the main drivers later in the presentation.

Let me move to sales from a regional perspective and start with Americas. Here, sales declined with 4%. Delays in installations continued in the quarter, and especially so in the South American market.

Turning to Europe, Middle East, and Africa, sales increased by 7%. The trend we saw in Q4 last year, with strong performance in the mature part of the region and weaker performance in emerging parts, continued in the first quarter this year. Finally, Asia Pacific grew 20%, with continued strong growth in China; and in this quarter also supported by strong performance in Japan.

Gross margin came in at 37.1%, significantly down from 45.9% in Q1 last year. The negative effect on gross margin from supply chain, logistics, and service costs continued and increased in the quarter. Conditions in the

freight markets are very challenging with both significantly increased costs as well as longer lead times. We also see higher material and service-related costs. The effect from higher supply chain, logistics, and service costs compared to Q1 last year were approximately 500 basis points. The main part of this is pandemic-driven and expected to be temporary.

FX impacted gross margin negatively with around 140 basis points, and solutions service mix had a negative impact of approximately 80 basis points. EBIT margin decreased to 6.7% mainly due to the lower gross margin. The net FX impact on EBIT compared to Q1 last year was positive SEK 48 million.

Net financial items improved as we now have a significantly lower gross debt level than last year. And the financial positions continue to be very strong with a net debt to EBITDA level of 0.4. The income tax rate in the quarter was 24%, in line with our forecast for the year.

Looking at the gross margin effect compared to Q4 last year, we see in this bridge that we had a decrease of 140 basis points from 38.5% to 37.1%. This was due to the already mentioned increase in supply chain, logistics and service costs, which had a negative impact of approximately 380 basis points, meaning that we saw an increase in these effects in the quarter. This was partly mitigated by the effects from the solutions service mix as we had more service sales in Q1 compared to Q4 last year.

Let's move into expenses, which increased 8% versus Q1 last year. Selling expenses increased to 22%, reflecting the more normal market conditions, resulting in higher travel and marketing costs. However, compared to last quarter, our Q4, the increase was small with only 2%. Admin expenses increased 1% as we continue to see efficiencies here. Compared to Q4, we had lower admin costs.

R&D increased 4% versus last year and 14% against last quarter. This is in line with our plan to accelerate investments in innovation, but also reflecting a relatively low capitalization level in the quarter due to fewer R&D projects [ph] being in phases where we can (14:12) capitalize. Gross R&D increased to 12% of sales rolling 12 months.

We have seen and continue to see significant effects from COVID on our costs. Travel and marketing has increased compared to Q1 last year, but are still clearly below pre-COVID level. As discussed previously, we do expect and target having permanently lower travel and marketing costs as we work more with digital solutions. As already discussed, we have also seen very significant increases in logistics and cost to serve our installed base. Both compared to last year and pre-COVID, we expect the majority of these increases to be temporary in nature, although it's difficult to predict exactly when this situation will normalize and lead to lower and more normalized costs.

Moving on to cash flow, cash flow after continuous investments came in at minus SEK 343 million and we had a rolling 12-month cash conversion of 77%. This was lower than the very strong performance in Q1 last year, but more in line with historical first quarter cash flow performance. The lower cash flow was mainly due to lower earnings, increased net working capital and investments in R&D.

Let me also comment on working capital performance. Net working capital increased in the quarter and is now back around the 4% levels of sales we saw for most of last year. Due to difficult conditions in the freight markets, we are shipping earlier to mitigate the longer shipping times and to make sure our products reach customers in time for installations. This led to the increase in inventory in the quarter. The change in our liabilities was mostly due to year-end related accruals that were paid in Q1.

With that, I hand over to you, Gustaf.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

Thank you, Johan. And I will say a couple of words on the Q2 outlook and our mid-term outlook. But if we start with looking into the quarter where we are now, we expect the overall market recovery and the situation to continue to improve and recover and also the ability to do installations to also improve. We expect also that we will see higher supply chain and logistics costs and longer lead times also in Q2 and that impacts our margins and our installation volumes.

We also see some risk in some markets for new waves of the pandemic, especially in emerging markets with low vaccination rates. That increases a bit the uncertainty on especially order volumes I will say. But overall and midterm and long term, we are convinced that the market trends to support growth and investment in high-end radiation therapy and cancer care equipment will be there and that we will expand our margins.

So, turning then to the midterm outlook, we are again presenting growth of more than 7% net sales CAGR until 2024/2025, EBIT percentage expansion over the period and the capital allocation of more than 50% of annual net profit in dividend.

So, to summarize our first quarter, we saw a continued recovery in the market. We increased our solution revenues and our installation volume. We experienced temporary headwinds to our gross margin. And we had a deep and strategic partnership with Philips. And we've also executed on our strategy going direct in new markets and also getting FDA clearance for Harmony.

So, thank you for listening. And with that, I hand it over to Cecilia.

Cecilia Ketels

Head-Investor Relations, Elekta AB

Thank you, Gustaf. We will now open the lines for your question. And, please, if possible, state your question one at a time. Let's make it easier for us. So, please, operator, over to you.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question is from Veronika Dubajova of Goldman Sachs. Please go ahead.

Veronika Dubajova

Analyst, Goldman Sachs International

Q

Hi, guys, good morning. I have two questions, please. One, Gustaf, I'd love to start with a little bit of an update on the environment. And I noticed in the press release you talked about towards the end of the quarter you saw some softening in momentum in North America. Just kind of curious what you think has driven that and whether that's persisted as you've moved into the second quarter both in terms of orders and installations. And kind of give us an update on the overall broader US hospital CapEx landscape from your side at the moment. Thanks.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Thank you, Veronika. So, on the environment and especially then in the US market, we have seen more COVID concerns, delays due to that. It's been the Delta variant has been driving that in some of our discussions on the US market. So, I perceive that as a more ongoing discussion and compared to, for example, Europe and especially China as well. So, we still foresee that there will be investments in radiation therapy, more towards your CapEx question. But we have a bit of uncertainty on the COVID Delta pandemic's impact on the US demand during the next quarter or so.

Veronika Dubajova

Analyst, Goldman Sachs International

Q

And, Gustaf, when you talk about the slowdown, is this in orders or in installations or in both? And I guess, what's your degree of confidence that none of this is being driven by the proposed reimbursement changes?

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

So, I think COVID impacts primarily orders I think in those discussions we have because of a bit of the uncertainty. The installations are not as impacted at because the hospital systems and our customers, they need radiation therapy capacity to treat the cancer patients and those patients cannot wait. So, I think that's more linked to orders. And for the reimbursement changes, that has not been the main discussion, so it has been more about the uncertainty linked to new COVID waves.

Veronika Dubajova

Analyst, Goldman Sachs International

Q

Okay. Thank you. And then if I can, just a quick financial question for Johan. Just, Johan, trying to kind of build the bridge on the gross margin and appreciate the 500 basis points is really helpful in terms of giving us some flavor for the headwinds that you're seeing. But obviously, you already had some of these in the prior two quarters. So, would just love to understand exactly where the incremental 300 basis points of headwind have come from this quarter versus what you had seen in Q3 and Q4, just so that we can have a better sense for the durability of that. Thanks.

Johan Adebäck

Chief Financial Officer, Elekta AB

A

Yeah. Yeah. Sure. So, it's both in, as we mentioned – I mentioned in my speech whereby freight cost has increased significantly, continue to increase, but accelerated, I would say, from what we've seen before. So, it's, to a large extent, across the board also when it comes to some material cost, but also cost to serve. So, for example, when we serve our machines, we have spare parts and so on. Instead of sending them back and repair, we have to use new ones all the time. So, it's across the board, I would say, when it comes to increased costs related to supply chain and logistics and service.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

And then, I think if you look at sea freight, if you look at packaging, if you look at raw material prices, there was a big spike also in the end of the quarter. And I think that that you see in the margins as well compared to one or two quarters ago, Veronika.

Veronika Dubajova

Analyst, Goldman Sachs International

Q

Okay. But would you say of the 300 bps incremental, most of it is freight or most of it is raw material?

Johan Adebäck

Chief Financial Officer, Elekta AB

A

I would say freight is more than raw material, that I would say.

Veronika Dubajova

Analyst, Goldman Sachs International

Q

Okay. Excellent. Thanks, guys.

Operator: Thank you.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Thank you.

Operator: Our next question is from Kristofer Liljeberg of Carnegie. Please go ahead.

Kristofer Liljeberg-Svensson

Analyst, Carnegie Investment Bank AB

Q

Thank you. One of my question was on the cost side. So, we could skip that. Given what you're saying about the continued improvement in the ability to install, should we read this as sales growth or the organic sales growth will probably then improve sequentially in the second quarter? Is that how we should read it?

And when it comes to orders, how much impact do you think – the comments about the US, is that something that will impact the order momentum you think for the group in the second quarter because, at the same time, you're talking about gradual further improvements of the market? Thank you.

Johan Adebäck

Chief Financial Officer, Elekta AB

A

Yes, a bit of uncertainty as we tried to mention here. But, so far, I don't think it is material. I mean in the North American market, the underlying development is still positive. So, I don't see – I mean disregarding the potential COVID effects, it's still a good market trend in North America alone and North America in particular, I would say, as we saw – if you look at the – we exclude that large GenesisCare order, the underlying trend was very strong in that market in Q1. And so far, we haven't seen any significant decline of that. We're not going to grow 80% in Q2, but it's still relatively good market conditions I would say.

Kristofer Liljeberg-Svensson

Analyst, Carnegie Investment Bank AB

Q

So, it's...

[indiscernible] (00:25:18)

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Sorry, Kristofer, please.

Kristofer Liljeberg-Svensson

Analyst, Carnegie Investment Bank AB

Q

No. But on the orders, the way I interpret it is that, right now, market is growing about 10% and that's the type of order growth we should assume with some pent-up demand.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Yeah. We have seen in the quarter, if you look at the market with all the public available information that's out there, it has been a significant uptake in order growth. I mean I think on the market side, [ph] we'd come (00:25:51), just looking at public data rolling 12 months, around 6%, something like that. So, the market has kind of recovered also from this extended U perspective that we referred to as well. And we are driving, of course, for growth in the coming quarter.

And on the installation side that you mentioned, Kristofer, of course, the ambition is to show growth versus Q2 last year. And we see better access to customers and you can also see that in our strong solution revenue in the quarter by 12%, but now we need to work a lot with the service revenue as well. So, that's a priority for the whole company.

Kristofer Liljeberg-Svensson

Analyst, Carnegie Investment Bank AB

Q

Okay. And my last question on the gross margin. Considering what you said about freight cost increasing towards the end of the quarter, does this mean that the gross margin could be lower in the second quarter than in the first quarter or is there also some seasonal effects and scale effects from higher sales that will offset that, so that we will see the normal, better margin in the second quarter than in the first quarter?

Johan Adebäck

Chief Financial Officer, Elekta AB

A

Yeah. A bit of uncertainty there as well obviously. But I would say I don't expect the gross margin to decline from these levels due to freight and so on. I think we will see, over time, a normalization of the gross margin, but a bit of a caveat though given the extreme movements we've seen so far. But, no, don't see further negative effects on gross margin in the coming quarter.

Kristofer Liljeberg-Svensson

Analyst, Carnegie Investment Bank AB

Great. Thank you.

Q

Gustaf Salford

President & Chief Executive Officer, Elekta AB

Thank you, Kristofer.

A

Operator: Thank you. Our next question is from Oliver Reinberg of Kepler Cheuvreux. Please go ahead.

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Yeah. Thanks very much. And I'd like to focus a bit on the top line. And I tried to reconcile your comment of improving access in terms of installation to the actual growth in solutions. I mean solutions were up 12%. But what we have to consider is obviously last year was down 14% if I remember that correctly, so there was a huge base effect involved. And I guess also what supported the growth is, on the one side, that unit installation likely have been stronger. I guess it probably added a mid-single-digit percentage of growth. And arguably also, you mentioned in the last quarter the issue with this too was the crisis. So, maybe there have been some kind of recovery in there as well.

Q

So, the question is really, short term, the solutions growth not has been stronger and has there been any kind of headwinds during the quarter?

Gustaf Salford

President & Chief Executive Officer, Elekta AB

If I start and then, Johan, please add. If you look at the volumes of installed devices that's really driving the solutions revenue, that has increased significantly in most of our regions. So, there is kind of a volume increase there supporting then the revenue increase. And we have also seen good Unity installation numbers in the quarter and so on. So, it's across all our different product areas of linacs, MR-Linacs, and Gamma Knives, as I think that's the positive development. And, of course, there was, you can say, easy comparison as you say, Oliver. But I would say that we're recovering back on the solutions side to pre-COVID levels I would say.

A

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Okay. And can you confirm that Unity was adding about a mid-single-digit percentage points to growth?

Q

Gustaf Salford

President & Chief Executive Officer, Elekta AB

I mean, we don't carve out the specific Unity growth, but it was a growth driver.

A

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Q

Okay. Fine. And the second question, I appreciate your comment obviously that the Delta variant had some kind of uncertainty in emerging markets going forward. I was just trying to understand how to really read that. Does it mean that the headwind on sales force from access to installations may actually get worst year-on-year, or you're just basically trying to say that the recovery is slower than expected, and in this case we would probably see a normalized market growth in terms of sales in emerging markets just with a bit less additional upside from recovery from installation access?

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Yeah. I think, Oliver, what I learned over this year is that it's very difficult to kind of forecast region by region or emerging or so on because when a market or a hospital system close down, it goes very quickly. So, a little more describing, on the overall level, it's improving, but it could be large variations particularly in emerging markets.

And I think we all need to be humble that that could happen very quickly and that's what we experienced in some of our quarters in the last year. But then often, you see now markets open up and you can drive growth in that market. But what we've seen, what we've heard is that markets like emerging Asia, excluding, kind of, China, that's still very challenging and also part of the Middle East and South America. So, depending on the Delta variant, that's kind of the uncertainty we see in the upcoming quarters.

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Q

All right. And the last question on top line, would you guide us for the back-end loaded year in terms of sales growth? I guess the Q4 comps are probably less demanding. Hopefully then there's also less issues with the pandemic. But is it a very back-end loaded year in your expectation in terms of sales growth?

Johan Adebäck

Chief Financial Officer, Elekta AB

A

Yeah. I think you're right. When you look at – we had a 1% sales growth in Q4. So, back to your comment on easy comparisons and so on, so that's at least favoring that when you compare year-over-year. Having said that, we had – as Gustaf said, we've had four straight quarters with growth. So, Q3 was relatively the strong one. As you mentioned, the comparisons have some effect. We have a easy comparison when it comes to Q4, that's what I would say.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

And I think it's helpful to look at slide number 9 in the material. It is this kind of extended U recovery that we foresee. And then, we come to higher growth in the end of the year. So, that's the perspective we can share.

Oliver Reinberg

Analyst, Kepler Cheuvreux SA /Germany/

Q

Okay. Perfect. Thanks so much.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Thank you.

Operator: Thank you. [Operator Instructions] There are no further questions at this time, so I hand back over to our speakers.

Cecilia Ketels

Head-Investor Relations, Elekta AB

Okay. Thank you very much and thank you, all, for participating in today's call. And if there are no further questions, we wish you all a good remaining day. Thank you and goodbye.

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