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Elekta AB (EKTAY.SE)

Q2 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 Second Quarter 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 highlights of our development, then Johan will give you details on the financials. And the presentation ends with Gustaf presenting the view on Elekta's outlook. After the presentation, there will, as usual, be time for your questions.

But, as always, before we start, I want to remind you that some of the information discussed on this call contains forward-looking statements. And this can include projections regarding revenue, operating result, 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, Gustaf, I hand over to you.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

Thank you, Cecilia, and good morning from me as well to everybody on the call. So, I would like to take the opportunity to present the highlights from the quarter. But first, I would like to start with talking a bit about our strategy, ACCESS 2025. And it's build, as you see here, on four pillars. It's about accelerating innovation with the customer utilization in mind; but it's also about driving partner integration across the cancer care ecosystem; we should be the customer lifetime companion and we're also about driving adoption of cancer care and radiation oncology across the globe.

But I think it's very, very important to also emphasize that the resilience and process excellence activities have been absolutely crucial during the last year to enable us to continue to support the customers and patients also during very, very challenging market conditions under COVID. And it's our almost now 5,000 fantastic employees and colleagues around the world that are implementing this strategy and making sure that it's delivered in a sustainable way.

And in the coming presentation, I would like to connect this strategy, ACCESS 2025, to the activities we have been driving in the quarter.

So, if we look at the Q2, we were able to accelerate innovation, and I think some very exciting progress around this when you look at expanding software projects into later phases and also a larger software engineer base around the world to address our customers' increasing need for streamline clinical workflows, automation and productivity.

At the recent ASTRO, we presented the latest technology updates for Unity, a clear step towards comprehensive motion management, and I'll get into this with more details later in the presentation.

We also received US clearance for our artificial intelligence module for auto contouring, a very promising step. And under the second pillar, if we move to being the customer companion, we are experiencing that during the quarter many markets open up. We got better access to our customers. We were able to meet them both at ESTRO but, of course, also ASTRO. We continue to build and drive our value-added services, a very promising area, and strengthening our digitalization offering, as well as our organization around service.

And when we will look at partner integration, we continue to develop our partnership with Philips, especially around software portfolio, and we acquired some software asset designed to streamline, accelerate radiation oncology workflows.

We developed other partnerships around patient-reported outcomes. For example, we have a recent agreement between our Kaiku Health and the Netherlands Cancer Institute, NKI, to develop the next generation of digital patient monitoring and management systems.

The fourth pillar is about driving adoption of radiotherapy across the globe. And we had opportunities to present our latest linac, Harmony, both in the US at ASTRO and also at the China International Import Expo, CIIE, for the first time and received a lot of interest and demand.

And during the quarter, we also strengthened our presence in the important markets of Turkey by acquiring a neuro distributor. We launched a sustainability-linked bond framework in the quarter, to give more people around the whole access to cancer care in underserved markets.

But after that strategic update, I would like to turn to our financial performance in Q2. Our orders grew with a strong 12% in the second quarter, and the growth for the first half was a more modest 3%. But if you adjust for the

largest deal ever in Elekta's history in Q1 last year, the underlying growth would be 14% for the first half. And if we look at the revenue development, and Johan will come back more to that in later part of the presentation, but we have managed the supply chain challenges well in the quarter. And after a very strong finish of the quarter, we arrived at an overall growth rate of 7%. And the growth came mainly from mature markets that grew with double digits.

I was also very pleased and after hard work we see a gradual increase of our gross and operating margins compared to the previous quarter.

And if we look a bit more on our markets and the order development, overall, we drove the strong order growth I mentioned in mature markets, but also in India and China. We are experiencing softer development in many emerging markets because they're still impacted by the pandemic and its consequences on cancer care investments and installations.

The growth in Americas was mainly driven by the US and Canadian markets that were returning to more normal conditions.

In EMEA, we had a very strong double-digit growth in Europe that's really recovering. But it was almost fully offset by order declines in the Middle East and Africa. In APAC, India, China, and Japan grew strongly, but we saw softer development in most other markets in the region.

And I would like to highlight a couple of important and very exciting orders in the quarter. And if you look at Ghana and there's a press release out as well on it, we received a large order from the Ghana International Children's Cancer Research Centre, a very exciting project where Elekta is a true partner when it comes to Unity, linear accelerator, Elekta Studio, software and service. We also received a large order from a North-West Hospital Alkmaar, in the Netherlands, including Unity, linac software and multiyear service orders. And we also saw Odense University Hospital in Denmark is ordering its second Unity machine in the quarter, as well as more linacs.

But if we take a bit of a longer perspective on the impact of COVID on our business and recovery, and we look at it at the 12 months rolling development, you can see that there is a continued gradual recovery towards pre-pandemic levels. Orders have been growing double digit over the last quarters when adjust for Elekta's largest deal in Q1 last year. Our revenue is still impacted by longer logistic chains, component shortages and late installation dates. But it had recovered very nicely over the last quarters. I'm also very pleased to see our installed base continuing to grow, in the quarter with 5%, enabling more cancer patients to get access to radiation therapy across the globe.

But if we come back to one of the strategic pillars in more detail, acceleration of innovation, we continued our investments in personalized precision, elevated productivity, and integrated informatics in the quarter. And it's based on our customers' increasing demand for streamlined workflows, automation, and productivity that's really supporting this acceleration of our digital transformation program by expanding our software innovation projects and also software engineering base.

And if you think about software, it accounts for around a fourth of Elekta's revenue, and we expect its importance to increase and also the growth to increase going forward. And some of the examples we had in the quarter was that requires workflow software from Philips, and it's designed to streamline, accelerate radiation oncology workflows, and we also received the US clearance for a software model around AI auto-contouring that I mentioned before.

Another very exciting area that's developing very fast at the moment is, of course, service. And our increased focus on service and the installed base and the rollout of cloud and SaaS solution is progressing very well with strong customer demand. Today, we can offer cloud solutions to more than 3,000 customers and we also see the strong growth coming from the installed base.

And just to give you some customer examples in this area, in the US, we had Oklahoma Cancer Specialists and Research Institute that have connected their site to cloud solutions. In the UK, we recently added leaders in oncology care to our SaaS customers, and it's really about entire treatment workflow that can now be run through Elekta Axis, our SaaS solution, with a goal to help employees to increase quality of care and reduce costs and streamline their resources.

In Singapore, we strengthened our partnership with Parkway Hospital Groups with installation of our cloud solutions in their radiation oncology department. That's a truly mixed vendor and multimodality site that's a true strength of Elekta. These value-added services is a very exciting area and will be key growth drivers for Elekta going forward.

But of course, I would like to give you an update on Unity. It's really about seeing the difference. And it has been a fantastic journey to be part of this Unity development over the last couple of years, after we received CE and FDA clearance. And now we have more, as you know, than 100 systems order, and we have more than 50 systems installed. And Unity is really allowing our customers to see what they couldn't see before. And there are so many different clear advantages of Unity.

As you see on this slide, if you start on the left, you see the foremost, and we discussed that a lot, is of course, the visualization capability. And it's truly a groundbreaking system enabling better treatments of cancer. Secondly is the precision to see the tumor and organ at risk in real time and enabling new ways of treating cancer tumors with precise and personalized radiotherapy. But it's also about the diagnostic quality of MR imaging, and it's about adapting to movement and acquiring massive amounts of data and insights from the machine. It's also about drawing insight, visibility, and control, the productivity for the clinicians, and improve it. Fifth, of course, it's about opportunities for improved outcomes and fewer side effects from radiation therapy.

And I have to say that last but not least, it's the Unity community gathering around this unique approach to innovation with hundreds of clinical partners. And this is really a true potential to revolutionize cancer treatment and radiation oncology.

And we are working with our partners to collect the evidence that proves the clinical benefit of Unity through multiple clinical research programs. And meanwhile, we have many of these clinical cases and patient stories that are illustrating the outcomes and benefits of the Unity system, and I would like to highlight some of these studies.

For example, if you take head and neck cancer, quite a complex cancer type to treat with radiation therapy, there is a interesting study on daily adaptive radiotherapy on tumors with Unity in the head and neck area, where you can adapt the treatment to the shape of the tumor – the shrinking tumor throughout the treatment. And this is enabling more precise treatments and sparing more healthy tissue and organs at risk.

And to the right, you see something very, very exciting. It is the single largest study on MR-guided radiation therapy in the literature with 943 patients. You also see a pancreas study, and pancreas is an important area for MR-guided adaptive therapy. And we now have studies on the delivery of curative doses to pancreatic tumors. So

more to come in these areas. And I think these clinical studies are examples of very, very important steps that we and our customers are taking on our clinical evidence as well as reimbursement journey.

But it's also about technology development on the fantastic platform that Unity is. And I would like to share with you some of the latest updates on Unity that we released at ASTRO. And this launch means that we now have three additional imaging options on our imaging capabilities, and that helps the clinicians of providing the best personalized treatment to the patients. And in total, we now have 14 imaging options to choose from. And this is very close to the 20-plus options that we have in the diagnosis department that is unique to radiation therapy industry.

But it's also about the important step, and this helps us to take the steps towards comprehensive motion management. That's about enabling best visualizations by reducing motions and resulting in better and sharper imaging during the motion, but it's also about driving productivity by faster imaging, a technology that can accelerate image acquisition by 30%.

So, if we now turn from our innovation and acceleration of innovation to sustainability, we have a very strong sustainability and transparent sustainability agenda that's fully linked to our strategy and recently we established our sustainability-linked bond framework to be completely transparent on our ambition and journey towards closing the radiation therapy access gap.

The quarter increase in installed base in underserved markets was around 40 units, which means around 14 million additional people got access in these countries to radiation therapy. This means that we're on track with our target within the sustainability-linked bond framework of reaching 825 linacs at the end of fiscal year 2024-2025.

So, with that, I would like to hand it over to Johan to give an update on the Q2 financials in more detail.

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. In the second quarter, total new sales – net sales grew 7%, with solutions sales increasing 8% and service up 5%. Growth was broad based with strong performance in MR-Linacs and Linacs. As a result, solutions was 61% and service 39% of sales.

Our EBIT margin came in at 14.4% for the quarter, significantly up from the first quarter. I will go through the drivers in more detail later in the presentation. For the first half, total net sales also grew 7% with solutions sales increasing a strong 10% and service up 4%. Also, here, growth was broad based. Solutions was 58%, and service 42% of sales in the first half of the year. EBIT margin for the first half came in at 10.9%.

Let me move to sales from a region perspective and start with Americas. Here, sales increased with a strong 24%. The growth was seen both in North and South America, with a good double digit growth rate in the US and strong development in Canada. Turning to Europe, Middle East and Africa, sales increased by 6%. Europe had strong development. However, the good European performance was offset by negative development in Middle East and Africa.

Finally, Asia Pacific decreased 2% as the pandemic related challenges continued. But, for example, Australia and Japan had good growth, and the strong underlying development of installations in China continued. Gross margin came in at 38.6%, down from last year and up from the first quarter. We saw positive effects from volume and

project mix, while the negative effect from supply chain, logistics and service costs continued in the quarter. Conditions in the freight markets continue to be challenging, with both significantly increased costs as well as longer lead times. Foreign exchange also had a negative effect on gross margin.

The negative effect from higher supply chain, logistics and service costs compared to Q2 last year were approximately 300 basis points. The main part of this is pandemic-driven and expected to be temporary. FX impacted gross margin negatively with around 100 basis points. The increase in gross margin compared to the first quarter came from positive effects from higher volume and project mix; the relatively small impact from supply chain, logistics and service costs and FX, and the negative impact from the high portion of solution sales in the quarter.

EBIT margin decreased mainly due to the lower gross margin. The net FX impact on EBIT in the second quarter was negative approximately SEK 70 million and negative approximately SEK 20 million for the first six months. Net financial items improved as we now have a lower gross debt level than last year, and our financial position continue to be very strong with a net debt to EBITDA level of 0.6. The income tax rate in the quarter was 24% in line with our forecast for the year. EPS improved to SEK 1 from SEK 0.98 in Q2 last year.

Let's move into expenses which were basically unchanged versus Q2 last year. Selling expenses increased by 14%, reflecting the more normal market conditions resulting in higher travel and marketing costs, and also both ASTRO and ESTRO taking place in the quarter. However, compared to last quarter, our Q1 expenses decreased slightly. Admin expenses increased by 8% from low COVID impacted level last year and with some one-offs in the quarter. Compared to Q1, admin costs increased with 3%. Net R&D decreased 19% versus last year and with 24% against last quarter.

Let me give some more details on R&D. As discussed on our Capital Markets Day in June, we are accelerating our R&D investments and gross R&D has increased to 12% of net sales on a rolling 12-month basis. In the second quarter, more R&D projects entered phases where we capitalized which resulted in a higher capitalization level compared to the first quarter. We also saw a decrease in amortizations in the quarter as Unity related software amortizations have ended. The increased capitalizations and decrease in amortizations both contributed to the lower net R&D expense.

Let me also comment on working capital performance. Net working capital increased in the quarter to minus 2% of net sales and continued to be in line with levels we have seen in the last two years. Due to the 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 means we are carrying more inventory than normal and inventory increased in the first half of the year. The change in other liabilities was mostly due to a year-end related accruals that were paid in Q1.

Moving on to cash flow, cash flow after continuous investments came in at minus SEK 360 million for the first six months and we had a rolling 12-month cash conversion of 71%. This was lower than the very strong performance last year but more in line with historical cash flow performance. Cash flow, after continuous investments in the second quarter, was minus SEK 17 million. The lower cash flow was mainly due to the lower EBITDA, increased net working capital and investments in R&D as discussed on the previous slides.

With that, I hand it back over to you, Gustaf.

Gustaf Salford

President & Chief Executive Officer, Elektá AB

Thank you, Johan. And now I'd like to say a couple of words about our outlook for the next quarter and the current quarter, Q3. So, what we expect and what we see right now is that we see a continued market recovery and leading to continued strong demand in most parts of the world. However, we also see that the supply chain challenges will continue for a couple of quarters and it will potentially have an impact on revenue and margins.

Throughout the end of the quarter, we've seen increased risk of component shortages in our linac production, but we're managing it well, but we've seen the risk increase a bit in the last month and weeks here. But we see the very strong long term markets trends to supporting the growth and investments in high-end radiation therapy equipment and margin expansion. And you see a lot of examples around the world of this, in Europe with the European Beating Cancer Plan, also in the US and in China and many other countries that are now driving national programs to invest in cancer care and radiation therapy.

So, if we take a little longer look, the midterm outlook until 2024-2025, we truly see that we can grow with more than 7% net sales CAGR over the period. We should also deliver a margin expansion – the EBIT margin expansion over the period, and we will have a capital allocation policy of more than 50% of annual net profit in dividend.

So to summarize the second quarter for Elekta, we experienced a strong order growth throughout the business in a recovering market mainly driven by mature markets. We saw our installations to be continued on a more normalized level driving growth, especially in North America, Europe and China. We did a lot of progress in our innovation and collaborations and partnerships, focusing on software and comprehensive motion management for Unity. We saw the gross margins improved from the low levels in Q1 due to volume increase and improved project mix.

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

Cecilia Ketels

Head-Investor Relations, Elekta AB

Thank you, Gustaf. Concerning this sharper imaging option at Unity that Gustaf talked about, I would like to inform that if you are interested in hearing more about this, there will be a webinar on the topic on December 7. It will be hosted by our Distinguished Scientist, Kevin Brown. And you will hear Dr. Alongi from Negrar talking about his experience with this new image option. You can find this webinar on our website or you just email IR, and we will just send you a link to register to this webinar.

So with that, we open the line for questions. Please operator, over to you.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Question comes from the line of Erik Cassel from ABG. Please go ahead.

Erik Cassel

Analyst, ABG Sundal Collier AB

Q

Hi. Morning, everyone. So, I have a couple questions for you today. And first off, I would like some details on the supply chain and component issues you're talking about. How should we think about the development over the coming quarters? Are we to expect that the worst supply chain issues are behind us, but that the component problems could intensify? And in that case, how much of a problem could this become?

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Yes. Thank you for the question. Hi. So, I think the logistic challenges has, of course, been built up and we followed that closely, all of us, of course, over the last quarters. The sea freight rates has gone up with 500%, 600% if you take a rate from, say, China to Northern Europe, and it takes much longer as well, it's almost double the time and there's port congestion, and we all know that. But what you can see in the indexes and the price levels, it's actually going down. So, that's at least an indication that we may be seeing the worst on the logistic challenges around the world, and we also learnt a bit more how to deal with it, I would say. Because we have a manufacturing hub in China, as you know, for linac accelerators, and we also have one in the UK, here in Europe. So, we have options when how and when we ship.

So, as you mentioned, I foresee that that will improve, it's more that how fast improvement will take. The cost levels are still very high. So, we experienced that in this quarter as well, as you see in the gross margins.

But if you take the component challenges, for Elekta, that hasn't been a big – big challenge over the last couple of quarters. But now, we see bigger shortages for smaller components for linacs, for example, that we work day and night to get hold of. But we are competing, of course, with many other industries for these components as well. So, I think we have – we manage it very, very well, but I see a heightened risk for component shortages over the next couple of quarters. And then at some point in time, it needs to be in balance again, of course. So, it's a bit of a shift there from logistics to components for Elekta.

Erik Cassel

Analyst, ABG Sundal Collier AB

Q

Okay. Thank you, Gustaf. And then obviously a very strong quarter for the US, but you do mention that you were held back by shortages of contractors. So firstly, how large was this shortage effect on sales? And secondly, do you expect this to be sort of a lasting constraint, or should we just see installations rolling into Q3 and making that a strong quarter instead?

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

If you look at – I'll start and I'll hand it over to Johan. But if you look at Elekta's revenue on a rolling 12 months basis throughout the pandemic, we have been very resilient compared to many other companies in the industry, but also in med tech. So, we've been able to install and deliver service throughout the pandemic.

We are still holding back to some extent. Some customers want a bit later installations. It takes a bit longer time due to COVID. But as we see – I mean, the cancers that are detected now, they have pushed back. So there is a huge cancer care backlog that the healthcare systems in Europe, in US, in China, needs to take care of. So I foresee that there will be a big push to do more installations in these markets to take care of these undetected cases that's at some point in time would be required cancer care.

So I think I'm still positive on kind of demand and the pull from the market, but there is, of course, a bit of friction in COVID-impacted markets, and the logistics change takes a bit longer compared to a normal level. And maybe, Johan, you want to...

Johan Adebäck
Chief Financial Officer, Elekta AB

A

Yeah. It's difficult to quantify exactly how much the impact is. But it's clearly so that in the US, in particular, there's shortage of people or people to work, including in this field. So, I think that's also a COVID-related impact we're seeing. But it's difficult to have a forecast on when it will be reduced. But I expect – well, maybe in the coming quarters, that will – I would expect that to be improved at least.

Erik Cassel
Analyst, ABG Sundal Collier AB

Q

Okay. Thank you. And then sort of a follow-up on installations, can you comment anything on the visibility you have of Unity installations right now? Are you seeing improved hospital access, or are installations being postponed? And then is the dynamics different to the rest of the linac portfolio?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

No, I wouldn't say the installations in Unity is so much different, and we had a very strong installation volume in the quarter. So I would say we're managing to install Unitys around the world in a very good pace. And we have a strong backlog to work with and get the installations. And I think a fantastic example was in Japan, where the site Chiba treated their first patient in the quarter, and that was very, very encouraging for that market. So we see the installations going well for Unity. So I don't see any different dynamic there really compared to regular linacs, I would say.

Erik Cassel
Analyst, ABG Sundal Collier AB

Q

Okay, perfect. And then can you say anything about how the conversion of orders [indiscernible] (00:33:13)...

Cecilia Ketels
Head-Investor Relations, Elekta AB

A

I think we need to let some other in the queue [ph] come from (00:33:19). Can you please just put yourself in the back of the queue and then we take your questions after that, okay?

Erik Cassel
Analyst, ABG Sundal Collier AB

Q

Yeah, sure. Sure. Sure. Thank you very much.

Cecilia Ketels

Head-Investor Relations, Elekta AB

A

Thank you. Sorry.

Operator: Next question comes from the line of Rickard Anderkrans from Handelsbanken. Please go ahead.

Rickard Anderkrans

Analyst, Svenska Handelsbanken AB

Q

Right. Good morning and thank you for taking my questions. So first one, a little bit on the US...

[Technical Difficulty] (00:33:43-00:33:49)

Cecilia Ketels

Head-Investor Relations, Elekta AB

A

Hello? I think we lost you. Maybe we can take the other person – the next one in queue, the third one, and then we come back to you at Handelsbanken. Okay, operator, can you put the next one since we cannot...

Operator: The next question is Veronika Dubajova from Goldman Sachs. Please go ahead.

Veronika Dubajova

Analyst, Goldman Sachs International

Q

Good morning and thank you for taking my questions. Two, please, for me. One is just kind of the R&D capitalization and amortization, just wondering, Johan, if you can give us a little bit of guidance of how we should be thinking through the development here for the remainder of the year and then maybe also into next year. Obviously, quite a big step up in the capitalization rate in particular, so if you can help us think through whether that's sustainable or not and for how long, that would be helpful.

And then my second question, and apologies, I caught this in the prepared remarks, and I – maybe you did put out a press release and I just missed it, but, Gustaf, did I hear you say that you acquired some software from Philips? And if so, what software is this? And can you give us some color, any desire to do more deals like that? Thank you.

Johan Adebäck

Chief Financial Officer, Elekta AB

A

Hi, Veronika. So I'll start with the R&D piece. So, obviously, we've – as we talked about on the Capital Markets Day, we are accelerating our investments into R&D. And if you look on Q1, we saw a clear increase in gross R&D spend in that quarter. We are now in the phase where more of that increase is feeding into projects which are capitalizable. So that's really what's driving the high capitalization level in the second quarter.

Looking at amortization, again, in line with what we presented at the Capital Markets Day, they reduced in the second quarter, as some older projects related to Unity came off from amortizations. Looking forward, I would say we will see a continued gross R&D continue somewhat – to increase somewhat, capitalizations to increase somewhat. Amortizations will go up again a bit as we have more projects coming online there. So, I would say somewhere in between what we saw now in the Q2 and what we saw in the first quarter is what I would say as a forward-looking statement on the net R&D piece.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Yes, Veronika. And around software, as you know, we are investing and we're also acquiring functionalities and features for radiation oncology workflows and patient-reported outcome. Kaiku was one example a bit more than a year ago, but we have also during the quarter acquired IP and also transferred teams when it comes to radiation oncology workflows from Philips. So, it's part of our partnership but it's also a way for us to further strengthen the oncology workflow and also the interoperability between imaging and radiation therapy. So, I think that's an important step and we'll continue with that technology development.

Veronika Dubajova

Analyst, Goldman Sachs International

Q

Thanks, Gustaf. And just to be clear, this is for workflow or this is for treatment planning? And is this product commercialized already or you're working on commercializing it? Apologies, I know it's a lot of questions, but I'm trying to get a bit of color.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Yeah, of course – it's not treatment planning, so to say...

Veronika Dubajova

Analyst, Goldman Sachs International

Q

Okay.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

...to be clear on that point. But it's on workflow. So yes, it is clinical and – or it's used at customer sites, this workflow solution at the moment.

Veronika Dubajova

Analyst, Goldman Sachs International

Q

Okay. Okay. That's great. Thank you, guys.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Thank you.

Johan Adebäck

Chief Financial Officer, Elekta AB

A

Thank you.

Operator: And we will just try it from Rickard Anderkrans again.

Cecilia Ketels

Head-Investor Relations, Elekta AB

A

Is Anderkrans back? Can you please see if we can reach him, operator?

Operator: Yes. Please go ahead, Rickard.

Rickard Anderkrans

Analyst, Svenska Handelsbanken AB

Q

All right. I'm trying again. Hopefully, you can hear me, I had some issues with the headset there. So, thank you for taking my questions. First one on the US and the developed markets in EMEA, clearly, a strong trajectory there. Was there any market share gains you would like to mention that's developed in any of your markets, particularly perhaps in the US?

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Yes. Happy to talk a bit about market shares. And if you follow that throughout the years in our Annual Reports and so on, we have been taking up the market share throughout the last years when it comes to radiation therapy. If you look at the last quarter, which has been quite stable across the quarter in our data, so we're holding our market shares, and in some areas we're also increasing our market shares.

I think if you take a little bit longer perspective going into US with GenesisCare and taking larger share there, it has been an important initiative for us, of course. And we are very strong in China and continue to be very strong in China as well. And emerging market has always been a strength of Elekta. So, I'm positive on our market share as well.

Rickard Anderkrans

Analyst, Svenska Handelsbanken AB

Q

All right. Thank you. And a final one, can you comment a little bit more on the near-term hospital access here for order conversion there given the recent COVID resurgence and a little bit on the near-term risks or how you view that sort of accessibility, if you will?

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

I would say accessibility to install new linacs is there because the healthcare system, the cancer clinics, they need to treat more patients. Sometimes it takes a bit longer because of logistic chains or that the customer maybe want to delay it a bit but we get the access for sure. And then I think both Elekta and our customers throughout the pandemic has learned how to work with these processes, for example, installations also during COVID.

Rickard Anderkrans

Analyst, Svenska Handelsbanken AB

Q

All right. Thank you. That's all for me. Thanks for taking my questions.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Thank you.

Operator: Next question comes from the line of David Adlington from JPMorgan. Please go ahead.

David Adlington

Analyst, JPMorgan Securities Plc

Q

Hey, guys. Thanks for taking the questions. Just following up on Veronika's point on the R&D capitalization. So – and that's doubled since this time last year, and it's up 30% on Q1, whereas amortization is going the other way. Amortization is down 30% year-on-year and 25% on Q1. So I'm just wondering what's driving that volatility. What's changed between Q1 and now? You talked about sort of projects getting towards the capitalization phase. And is that one big project or is that lots of small ones? And when should we expect to see those products launch and therefore the amortization and capitalization to swing around?

Johan Adebäck

Chief Financial Officer, Elekta AB

A

Yeah. Hi, David. So, back again to I would say refer to what we showed at the Capital Markets Day around this. So, we are, as you know, and as you see in the also R&D spend numbers, accelerating investments into R&D. It's not like with Unity we did a number of years back with one large project, these are very much more smaller ones around software, the linac family, and to some extent, Unity as well. So, it will be smaller changes. Not this big change with where one big project goes into amortizations and so on. We have some couple ones, which I mentioned in the previous answer, that will start to amortize in the coming quarters, [ph] so I see (00:42:08) amortizations going up. So, that's really – but it's not one single big event that will drive it.

And why is it coming up – going up now? Well, we saw that rather steep increase in gross R&D in the first quarter, and, obviously, it takes a while for that really to feed in to projects that are capitalizable, so I think that's the reason why we see that. It's a follow-up effect, I would say, from the increase in gross R&D we saw in Q1 where capitalizations increase we see in Q2.

David Adlington

Analyst, JPMorgan Securities Plc

Q

Okay. Great. And then maybe just a follow-up on that, I mean, you only – fairly recently launched Harmony, so I was quite surprised to see the amortization come down. Was there anything else we should be thinking about there?

Johan Adebäck

Chief Financial Officer, Elekta AB

A

Yeah. What's come down now is related to Unity. So, the decrease in the quarter is related to amortizations from Unity going – being finalized.

David Adlington

Analyst, JPMorgan Securities Plc

Q

Okay, understood. Thank you.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Thank you.

Operator: Question comes from the line of Oliver Reinberg from Kepler Cheuvreux. Please go ahead.

Oliver Reinberg

Analyst, Kepler Cheuvreux



Well, thanks very much for taking my questions. Three, if I may. Firstly, on visibility. Johan, I think in the pre-close call, you talked about the expectation of flat installation volumes year-on-year. Now, you show basically kind of 8% of growth in solution, which is, I guess, a kind of positive surprise. But can you just talk about this kind of major deviation that you experienced in the kind of, I guess, last weeks of the quarter and what visibility you generally have in this?

Secondly, on Varian, Siemens obviously hosted their kind of Capital Markets Day, and Varian now aims for 9% to 12% sales growth going forward, providing certain new benchmarks. So, can you just talk about it? Is that something you also aspire for? And can you just talk about the kind of pulls and push that you see? I guess Unity probably provide some kind of support. And I guess also in terms of regional mix with more exposure to emerging markets and less in the US, which should work in your favor. So, what are the kind of counterarguments for you to probably provide lower growth than that?

And then the third question, please, just on gross margin. Are you confident that you can further increase the kind of gross margin in the second half compared to Q2? And, I guess, you have seen some kind of support for mix. So, is there any kind of risk that this kind of mix will normalize, respectively deteriorate, which is a potential risk for gross margin going forward, or should we expect a further progression from here? Thank you.

Johan Adebäck

Chief Financial Officer, Elekta AB



Thank you. So, I'll start with visibility. And I agree it came in better than what we said at that call, and it's been great job done by supply chain people really to make sure we get these installations in a time of – when you do the numbers, I mean, we had solutions sales in the second quarter of SEK 2.2 billion roughly. So, that deviation equates to around SEK 100 million. So, we had one Unity, we had one Gamma Knife, and a number of linac projects that came in, that were really questionable. But great job from our supply chain employees to really get things into and installations done in a very – still very challenging environment. So, that's – again, that would – reason behind the better performance than what we saw – when we had that in the call.

Gustaf Salford

President & Chief Executive Officer, Elekta AB



Yeah. And Oliver, I think on competitions view and guidance going forward, I think we all saw positive on the market and it's great to see that they also see a good opportunity for radiation oncology to continue on – grow good levels going forward. Then I think it's fair to say, it's maybe not the full like-for-like comparison. We believe the radiation therapy market as we said in the Capital Markets Day to grow somewhere around 6% to 8% going forward, and we are growing revenue more than 7% throughout that period.

I think we kind of share a view that radiation oncology, but also value-added services and software, as I mentioned in the presentation, has a good opportunity to grow faster. I think also with Unity, as we've always said, we have a fantastic opportunity to grow faster than the average radiation oncology market. So, I think that's my perspective on the competition's recent communication around market growth.

Johan Adebäck

Chief Financial Officer, Elekta AB



And then the third one, on gross margin. So, if I go back to what's impacted gross margin negatively in the last year or so, is these supply chain logistics and service costs, and also to some extent foreign exchange that's had

negative effect on it. But we've been around 38.5% now, three out of four last quarters and with one outlier in the first quarter of this year.

So, really the question becomes how will these things, the logistics and so on develop going forward and how will foreign exchange develop going forward. It's difficult from that perspective to say, and we're not going to – we're not guiding on gross margin really. But I would say if you look at the numbers, the development we've seen in foreign exchange the last few weeks with the dollar strengthening significantly, that will, everything else equal, have a positive impact on gross margin. And as Gustaf said, we do see some early signs of logistic costs or logistics freight costs coming down somewhat. So, possibly that's a sign that this will normalize in the coming quarters also. That's the comment I would give on gross margin.

Oliver Reinberg

Analyst, Kepler Cheuvreux

Q

Very helpful. And Gustaf, maybe just a follow-up. So, can I just ask the benchmark of Varian, so there's no structural reason that you see why you should underperform their ambition without providing any kind of hard guidance obviously, or is there any kind of structural element that we should take on board?

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

No. I wouldn't say so. But I think it's not the full apples-to-apples comparison. They are in some segments where we are not, so I think that's important to factor in. And I think we share a very positive view on oncology and radiation oncology and radiation therapy that this is a market that would grow strongly going forward supported by services and software growth as well. I also see that with the technology and product portfolio we have with Unity in the lead, we have a very strong offering to the customers to protect and take share.

Oliver Reinberg

Analyst, Kepler Cheuvreux

Q

Super. Thanks very much.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

And maybe, Oliver, I think it's also important, I want to highlight that, that I think there is a bit different models. I think Elekta has always historically been standing for open model, multimodality, multi-linac centers that we, with our software platforms and our linacs platforms, are very well suited to offer the customers that offering. So, we have this kind of open strategy and we'll continue to do that going forward as well driven by a lot of partnerships.

Oliver Reinberg

Analyst, Kepler Cheuvreux

Q

Very helpful. Thank you, Gustaf.

Operator: Next question comes from the line of Scott Bardo from Berenberg. Please go ahead.

Scott Bardo

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Yeah. Hi, guys. Thanks for taking my questions. So, first question, please. Clearly you've seen around 7% growth for the first half. And I think you're talking about reasonable accessibility into hospitals and clearly pent-up

demand order backlog. So, question for you, Johan, Gustaf, do you feel confident enough at this point to say that this year should be at or above the sort of midterm 7% trajectory that you foresee? Any comments there actually would be helpful.

Second question, please. I think you've been highlighting around 100-plus Unity orders for the last six months or so now. And I appreciate you don't want to get too granular, but it would be helpful to get a little bit of steer actually as to what the real numbers are, rather than rounding to three significant figures. So, if you could give us some sense of how that's progressed since when you announced that 100 milestone in July are helpful, please.

And last question, a bigger picture one for you, Gustaf, please. Obviously your competitor, Varian, is also highly interested in adaptive radiotherapy, launching Ethos in January last year, in 2020. They've also recorded 100 orders in a very short window of time. I think most of those also in the same hospitals that have an MR-Linac. So I'd like to understand, does Ethos, in a sense, in your opinion, complement an MR-Linac, or is it in fact that hospitals that have an MR-Linac are now going with an alternative rather than ordering more MR-Linacs? Just some thoughts around that, please. Thanks.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Of course. On the first question, I think we will not highlight any more views on this year's revenue growth going forward. I mean, we keep our mid-term guidance of more than 7% and the margin expansion throughout that. I think the first two quarters, we have been delivering good growth in the current market conditions when you take revenue, but of course also orders. So I think that's what I can say on it. I think there is a recovery going forward. We have some logistic challenges and component shortages that we're dealing with, but we see also we have a strong backlog, so we have a good backlog to continue to deliver installations from going forward as well.

If you take the numbers around Unity, you're right, we haven't done these kind of quarterly updates on orders or revenue. I mentioned in the call a bit earlier that we had very strong Unity revenue in the quarter, and it's very – I'm very happy to see that. Then we see shorter installation times, we've been on a steep learning curve, of course, since we started with Unity when it comes to how long it takes to do installations and so on, and that's much shorter to date than previously.

On the order side, I think if you take the full period under COVID, the Unity orders slowed down a bit, but we see a very good sales funnel. We had seen good order numbers as well in the last quarters here, but we don't focus on any specific numbers within the quarters.

So if we then move to the – I would say, the industry trend on adaptive, that we are really driving with Unity, with the MR-Linac adaptive way of treating cancer, but of course, you can do it with CT as well. So it's not modality specific from that point of view. So adaptive is a big trend in the industry and you hear a lot about it at ESTRO and ASTRO and will result in better treatments. But it's also important to say that you get different types of information, insight, data, ways of treating if you have a CT image or cone-beam CT image versus an MR image. So with MR, you get a lot more information that you can follow the treatment and how it reacts – or the tumor, how it reacts on the radiation throughout the treatment.

And this is also, I think, a strong argument for us to see that we should be reimbursed for that additional insight and new ways of treating cancer types and tumors that you couldn't treat with a cone-beam CT or a CT-enabled workflow, and really moving to what we now see, motion management. And you can just take the example from the imaging industry, you will have different reimbursement codes for CT and MR reimbursements. And I think for

us, it's so important that MR gets that fair reimbursement for all the additional insights, capabilities, image quality that we offer to customers.

So I think that's my perspective on your question around adaptive. But of course, overall, we are very positive on adaptive, both on the CT side and on the MR side.

Scott Bardo

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

That's helpful context. And any further developments on the reimbursement front yet, Gustaf? I know you highlighted this at the CMD.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Yes. It's a massive amount ongoing around the world when it comes to reimbursement. So it's translating the clinical evidence that has been developed since we started to install the Unitys around the world. So of course, we focus a lot on the US. We focus a lot on European countries. We have processes in China, in Japan, in Australia, New Zealand. So it's an ongoing work.

Now I think it's so important, and you all know this, but in med tech, it's very different from pharma how you deal with reimbursement. You start with a clinical utilization within that country. You established a clinical evidence with the user. So doing that, we help them with the MOMENTUM study. And then you also have – discussing with the payers about the new codes and payment requests. And I think as we have always said, this started now in 2021 and 2022 all of these discussions when it comes to payers. And it would be gradual journey when it comes to reimbursement, but I'm very optimistic on the discussions that we're having right now around the world.

Scott Bardo

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Thank you very much.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Thank you.

Operator: Next question comes from the line of Kristofer Liljeberg from Carnegie. Please go ahead.

Kristofer Liljeberg-Svensson

Analyst, Carnegie Investment Bank AB

Q

Yeah. Thank you. I'll try to be quick here. First, coming back to this increased R&D spending, would it be possible to highlight maybe one or two of those projects that are most important? I know some years ago, you had talked about the new linac platform. So, when is it time to launch that maybe? And then on operating costs, sales and marketing, how should we think about that going forward? You had both ESTRO and ASTRO in the quarter, you said. But I guess we should also see more traveling and general activities here, coming quarters and into next fiscal year. Well, third question, when it comes to capitalized R&D, does that make up all of the intangible investments, or do you also have the IP investment from Philips in there, if you could comment on that? Thank you.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Thank you, Kristofer. So, I will start with kind of the product development pipeline. So, you get an indication of when we say that a lot of R&D innovation investments are going to three main areas. So, you will see software transformation, and that's built upon a new software platform where we'll put all our future software functionalities on top of that platform to enable cloud services and value-added services on top of that platform, and that's a big undertaking, but it's maybe not the product of itself. It would be the models you put on that software. So, a lot of our software investments is going into that area, and that's something we have been investing in, say, two to three years. And it's progressing very well.

And then the other area that...

Kristofer Liljeberg-Svensson

Analyst, Carnegie Investment Bank AB

Q

So sorry – sorry about this.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

Yeah?

Kristofer Liljeberg-Svensson

Analyst, Carnegie Investment Bank AB

Q

Sorry. So you see modules going into an existing platform or are you developing a completely new platform?

Gustaf Salford

President & Chief Executive Officer, Elekta AB

A

No. So, completely – the underlying software architecture and underlying platform, that is what we have been developing throughout the last couple of years. On top of that platform, we will put the new products, the new modules that will support a clinic or oncology information system or treatment planning software, and other functionalities like what we call ProKnow, where you compare treatment plans, or we talk about Kaiku that's patient-reported outcome. You put it on that platform.

And this is very important to have a faster, more agile way of offering our customers software solutions, and it's also a way to get more of the solutions up into cloud solutions and SaaS solutions going forward. So that's kind of if I may call it architecture infrastructure software investments. If you take that – that's what we call a software transformation as well and then we can also acquire companies to put on top of that platform. So, it's really a portfolio platform way of thinking about software.

The second area is, of course, as we always are doing, our family of linacs. So, it's the biggest segment we have in Elekta and we have projects – very interesting projects on the linacs side in our family of linacs going forward as well. I will not disclose any specific date or so on but I can assure you – assure that quite a significant part of our engineering and product management organization are working on that topic.

And then the third area, we see some outcomes actually in the quarter as well is on the platform of the Unity linac where you would see that – where we can put more motion management capabilities and different ways of being able to do adaptive treatments. So, that's something we will continue to invest in over the next periods in Unity

going forward as well, because there's so many opportunities with what you can do with the MR-enabled adaptive treatment going forward.

So, that's, I would say, the three key areas for innovation investments today and also during the coming years.

Johan Adebäck

Chief Financial Officer, Elekta AB

A

Okay. On your question on selling expenses, yes, they were basically flat compared to first quarter and also, I would say, against fourth quarter. Even though we had ASTRO and ESTRO in the second quarter, I should say ASTRO and ESTRO were not as big as they may have been historically. So, the impact is smaller than what we've seen in pre-COVID times. But I would say we continue to see efficiencies in selling expenses and not least around how we work with travel and marketing, and we highlighted that a bit, I think, in the last call we had that they will continue to be on lower levels from what we saw pre-COVID.

On the capitalized – the Philips, no, that's not in capitalized.

Kristofer Liljeberg-Svensson

Analyst, Carnegie Investment Bank AB

Q

Sorry, sorry.

Johan Adebäck

Chief Financial Officer, Elekta AB

A

Yeah?

Kristofer Liljeberg-Svensson

Analyst, Carnegie Investment Bank AB

Q

Could I ask – should we expect selling and marketing costs going up coming quarters and into next fiscal year, or is this the level where you will be now for a while?

Johan Adebäck

Chief Financial Officer, Elekta AB

A

I would say that this is the level, but also one caveat is that we still have markets which are hit by COVID, and if you look at how the pattern we've seen not least to travel and so on in the sales part of the organization is – maybe I call it a pent-up demand as well to see customers. There are still countries that are affected and were more difficult to travel to. From that aspect, we may see some temporary pickup. But overall, I would say this is a reasonable level, yes.

Kristofer Liljeberg-Svensson

Analyst, Carnegie Investment Bank AB

Q

Okay. Thank you for that.

Johan Adebäck

Chief Financial Officer, Elekta AB

A

Philips, no, it's not in capitalized R&D. It's in the business combination line in the cash flow statement if you look there.

Kristofer Liljeberg-Svensson
Analyst, Carnegie Investment Bank AB

Q

Great. Thank you very much.

Johan Adebäck
Chief Financial Officer, Elekta AB

A

Thank you.

Cecilia Ketels
Head-Investor Relations, Elekta AB

A

And we have passed the hour, but there are two more in the line for questions, one. And I would like to put that forward before we end the session. Operator, is that person still in the line? No? Okay.

Operator: Okay.

Cecilia Ketels
Head-Investor Relations, Elekta AB

Okay. So, if you have further question, please reach out to us personally then instead. And with that, I thank you for participating in today's call. Thank you and have a remaining good Thursday. Bye-bye.

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