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Elekta AB (EKTAY.SE)

Q2 2024 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

Mattias Vadsten
Analyst, Skandinaviska Enskilda Banken AB

Oliver Reinberg
Analyst, Kepler Cheuvreux

Kristofer Liljeberg-Svensson
Analyst, Carnegie Investment Bank AB

Hassan Al-Wakeel
Analyst, Barclays Investment Bank

Rickard Anderkrans
Analyst, Handelsbanken

Lisa Bedell Clive
Analyst, Bernstein Autonomous LLP

Veronika Dubajova
Analyst, Citigroup Global Markets Ltd.

Robert J. Davies
Analyst, Morgan Stanley & Co. International Plc

MANAGEMENT DISCUSSION SECTION

Cecilia Ketels
Head-Investor Relations, Elekta AB

Good morning, everyone, and warm welcome to the presentation of Elekta's Second Quarter 2023/2024. 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 starts off with Gustaf presenting some highlights of the developments then Tobias will give you details on the financials, and the presentation ends 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 on this call contains forward-looking statements, and they can include projections regarding revenue, operating result, cash flow, as well as product and product development. And these statements involve 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, everyone, and thank you for attending our call. We are really happy to announce that we continued to deliver on our strategy, ACCESS 2025 in Q2. We drove significant improvement and generated a fourth consecutive quarter with revenue growth and expanded EBIT margin. Order growth came back supported by large deals in both India and Ukraine and cash flow improved.

And if we now turn to our key components of the ACCESS 2025 strategy, we continued to strengthen our market leading Brachy portfolio with acquisition of Xoft, which accelerates innovation for brachytherapy in the Elekta portfolio. And during the quarter, we have also successfully driven adoption by expanding radiation therapy in both mature and emerging markets.

Our latest, Leksell Gamma Knife, Elekta Esprit, has celebrated great success during the quarter, many time reaffirm a very longtime customer companionship.

And in China, we have evolved a partnership with Sinopharm alongside already established partnerships within the cancer care ecosystem to reach a larger proportion of the Chinese hospitals and patients.

And if we go to the order development during the second quarter, we had a overall positive order trend and it's a sign of the large underlying demand for cancer treatment capacity. And this is, of course, after several years of underinvestment in many, many markets.

The book-to-bill ratio was 1.05, and the order backlog amounted to SEK 46 billion. And we continue to pursue a faster conversion rate.

Americas grew with 9% with a strong growth in Latin America. The growth in EMEA was driven by double-digit growth in Europe. The Netherlands continued a strong momentum, and Italy drove the European development. And we also saw a large deal to modernize and expand the installed base of radiotherapy in Ukraine. However, the growth in Europe was partly offset by low orders in the Middle East and Africa.

APAC, excluding China, had a very strong double-digit growth rates driven by great demand in India, Australia, and Japan. The weak order development in China is linked to the ongoing anti-corruption campaign in the health care sector, and it's temporarily impacting order volumes across the industry, and we expect Chinese order volumes to recover during Q4.

And this recovery is supported by strong outlook for the Chinese market with the recent launch of the five-year investment plan our Elekta Unity receiving A+ license and the joint venture with Sinopharm is proceeding according to plan, and also the latest, Leksell Gamma Knife, Elekta Esprit was launched in China during CIIE 2023. And we also will see that development going forward.

If we then zoom in a bit on some of the key deals and orders during the quarter, you will see here that as I mentioned earlier, that we saw a strong deal in Americas, the Panama South and it's really offering hope to cancer patients with the deal we have with the comprehensive portfolio to also take a leading role in the Central American region.

And during the quarter, we also signed a significant $40 million order for one of India's largest and most advanced corporate health care groups, Krishna Institute of Medical Science, or KIMS in Hyderabad. And the combination is really a solution that includes Elekta's full suite of hardware and software.

In October, we won a public tender to deliver several Harmony linear accelerators to help meet the demand for cancer care treatments with modern radiation therapy devices in Ukraine. And the first of this is linear accelerators are expected to begin treating cancer patients in 2024. And the Harmony systems, they will be placed in half of Ukraine's provinces, as well as the National Cancer Institute.

And if we now turn to revenue, we saw that Q2 was the fourth consecutive quarter of good revenue growth. Revenue grew with 10% supported by strong solutions revenue of 15%. And I think we have really shown the flexibility and resilience in our supply chain. And we are now in a very good place to continue to drive revenue growth and working capital improvements. And we're also addressing the continued impact that we saw quite a lot of in Q2 from inflation with price increases and new product launches across our portfolio.

All regions contributed to the strong growth with double-digit growth rates in both EMEA and APAC. And EMEA they showed strong growth both in Europe and the Middle East and Africa and installations in Europe were driven by recent large tenders in Italy and Spain, but also in the UK.

Most markets in APAC showed good growth in installations China, India, Thailand and in the Americas, revenue was stable in North America with good growth in Latin America. So, at the end of the quarter, Elekta had an installed base of approximately 7,250 devices.

And now to a couple of words around Xoft because in October, Elekta acquired the Xoft Business. And by acquiring the technology together we'll transfer employees, we really strengthened our position as a world leader in brachytherapy solutions.

The Xoft system is FDA cleared and CE Mark for the treatment of cancer anywhere in the body, using a miniatures X-ray source to deliver precise, concentrated dose of radiation directly to the tumor site.

The Xoft system has an installed base of more than install base of more than 100 systems and through Elekta's network, the Xoft technology will now be able to reach many, many more patients. This addition to our brachy portfolio will enable more flexible and mobile treatments, expanding cancer care to new areas with strong demand.

And then finally, a few words about the Annual ASTRO Conference in the US. And we can see that the our presence at ASTRO in 2023 here in San Diego turned out to be very successful with customer engagement significantly higher than the last years, as well as an increased amount of overall users and record high attendance at their own customer events.

Apart from launching our Elekta ONE software suite, the main attention at ASTRO was aimed at the important clinical breakthroughs of Elekta Unity's Comprehensive Motion Management that has featured by several thought leaders across Europe and the US. And these milestones marked the next phase of the Unity journey where clinicians are able to take the MR Linac technology to the next level of precision and adaptive treatments and this will be a key trigger for new Unity orders.

And now, over to you, Tobias, for a bit of a closer look at the financials here in Q2.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

Thank you, Gustaf, and good morning, everyone. I will start with the Q2 financials then. Our revenues continue to grow nicely in this quarter by 10% in constant exchange rates supported by, as you heard from Gustaf, double-digit growth in EMEA and APAC while the Americas turn to growth in the quarter. We could benefit from a healthy growth in mature as well as in emerging markets.

Profitability continued to grow strongly in this quarter by 370 basis points despite the lower gross margin than last year. Adjusted earnings per share grew by 70% in the quarter compared to last year.

If we look at the financial development in more detail, we can see that forex exchange rates had a positive impact on net sales of 6-percentage points, a negative impact on gross margin of 40 basis points while contributing positively by 180 basis points to our EBIT margin.

Then, look at the operational drivers to our gross margin. We benefited from the high sales growth combined with successful cost reduction. The relatively higher growth of solutions led to an unfavorable mix in the quarter. And finally, we experienced inflationary pressure from materials and salaries.

Moving down to our EBIT margin we see further benefit from improved operational productivity while growing strongly. Then, looking into our expenses in constant currency and adjusted for items affecting comparability.

All in all, despite the salary inflation, the operating expenses decreased 1% year-over-year, driven by cost reductions. Selling expenses increased by 4% year-over-year as we invested in more revenue-generating activities. Administrative expenses declined year-over-year following the cost reduction initiatives. And finally, net R&D expenses declined 6% year-over-year, driven by lower gross R&D.

We remain our focus on our innovation pipeline. As mentioned previously, we are targeting personalized precision through offering [ph] adaptive (00:11:27) CT Linacs and superior image quality. Elevated productivity targeting 50% cost reduction per treatment, and integrated informatics and decision support. Gross R&D continue to decline on a rolling 12 months basis and ended at 12% net sales in the quarter.

Moving over to the balance sheet. Net working capital as a share of sales ended at minus 3% in the quarter, which was lower than end of Q2 in the two previous years.

Higher customer advances was generated by increased shipments and order intake. Accrued income remained high due to larger shares of installations in Southern Europe, where billing terms are longer. And our inventories are on a relative high level to secure future installations.

Cash flow after continuous investment was more than SEK 600 million better than Q2 last year. This was primarily driven by higher earnings, but also a slight reduction of working capital. Following the improved cash flow in the quarter, we end the quarter in line with our target to be above 70% cash conversion.

Over to you, Gustaf.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

Thank you, Tobias. And now we turn to the outlook section and the outlook until 2024/2025 is the same. It is more than 7% CAGR on net sales. It is a continued EBIT margin expansion that we have shown in the previous quarters and it's also a dividend policy of more than 50% of annual net profit. All of this is in our focus on driving shareholder value in the coming quarters and years.

So, if we then look at the outlook into next quarter, we see that we have a revenue growth and EBIT margin expansion is also expected to continue, however, at the bit slower pace. The comparisons are a bit more challenging in the next quarter.

We also see continued inflation pressuring in Q3 and we also see that the long-term market trends is really supporting growth and investment in high end radiotherapy equipment and margin expansion.

So, if I then turn to the summary of Q2. We see a very strong order growth excluding China. We have shown the fourth consecutive quarter with revenue growth and expanded EBIT margin.

We have been driving improved working capital and cash flow. We see great momentum with market-leading product portfolio and highlights would be Unity and Elekta ONE and we have also acquired attractive expansion into Brachytherapy using a miniaturized X-ray source with Xoft.

Cecilia Ketels
Head-Investor Relations, Elekta AB

And with that, thank you, Gustaf. We will continue with a Q&A session. So, please, operator, can you open up for the first person in line?

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from the line of Mattias Vadsten, SEB. Please go ahead.

Mattias Vadsten
Analyst, Skandinaviska Enskilda Banken AB
Q

Hi. Thanks for taking my questions. I would start with one here. It's on the wording for Q3 in the sale. You said that the significant improvements will continue but at the lower pace. So, to me, this is not strange given the comps are less easy ahead, so to speak, based on the development sequentially last year.

So the question is really, is this the reason for this comment rather than something worsening sequentially or how should we look on it? That's the first one.

Gustaf Salford
President & Chief Executive Officer, Elekta AB
A

Yeah. First, I'll start with the first one. You're right, Mattias. It is linked to the comparison. We have shown strong revenue growth now for four consecutive quarters. So the comparison will be more difficult here in Q3.

Tobias Hägglöv
Chief Financial Officer, Elekta AB
A

Absolutely. I mean you saw here last year we had a Q2 of minus 5% growth and Q3 of plus 8%. So -and also a big difference in margins, so absolutely, Mattias.

Mattias Vadsten
Analyst, Skandinaviska Enskilda Banken AB
Q

Perfect. That's quite clear. Then how do you look upon momentum for Unity now? You mentioned it was strong on ASTRO. But can you comment on how the momentum has changed given the ViewRay situation perhaps? And also if you could comment on how many orders of installations you've had sort of since beginning of this fiscal year?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

So, if we take – thanks for that, Mattias. I will start here. So, if we look at the MR-Linac with Unity, we see a great momentum. It is linked to partly because we deliver Comprehensive Motion Management. That is a key technology to enable further adoption in many of the sites around the world. We see the clinical evidence coming out as well. We see higher throughput of patients per machine per day or per year around the world and that's very good for reimbursement and the profitability of the centers. We see also a bigger interest in public procurements. We see the Class A in China coming through. We see, of course, an opportunity with ViewRay exiting because we see a big interest in many of those sites to continue with the MR-Linac technology.

So although it's kind of sad I will say for the MR-Linac industry that ViewRay have been exited, we see it as an opportunity for Elekta to continue to deliver our technology around the world, to continue to drive this. What we see is a paradigm shift in radiation therapy.

If you then ask the question, I mean, we publish our yearly numbers on Unity order units and revenue units. So it's not a number we give out per quarter but it's a strong development at the moment.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

And we see a ramp-up sequentially as well.

Mattias Vadsten
Analyst, Skandinaviska Enskilda Banken AB

Q

Perfect. Then just on the gross margin, it looks like of course a headwind from delivery of some orders that you maybe took a long time ago. So could you comment on the headwind from external factors on the gross margin? Now, you mentioned some [indiscernible] (00:18:23) and how much is mix? And to what degree can we expect higher gross margin going forward? Can you comment anything when it's relevant to look at this sort of 40% trajectory again?

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Now, absolutely, and thanks for the question and it's relevant. I mean gross margin for us is obviously very important. I think, to start with, I mean I would actually look at the year-to-date numbers as well and I actually recognize that we have a higher gross margin than last year. I think that's a good starting point.

Secondly, when you look into the second quarter here, we have a very strong growth in our Solutions business, which is very positive for us. We grow this by 15%, as you heard Gustaf mentioned and this is good. It's just – mathematically, it leads to an unfavorable mix in the quarter but this growth we can then use to generate more service sales ahead of us.

Then talking about the gross margin and actually we stick to our plan, what we communicated at the Capital Markets Day and that is that this fiscal year it's more about the operating margin expansion, then moving into next year then the metrics on the gross margin will start to kick in. So that is actually in-line with what we communicated in-line with our plan. And of course we want to have a higher gross margin than 36% but it's again according to plan and it's actually, year-to-date, a better margin.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yes. And Mattias, if you look also at the inflation pressure, we see a lot of that in this quarter. So of course we're not pleased with the 36% but we had salary increases when we started our fiscal year. We still see material costs being high. Logistics cost has gone down as we mentioned in the last quarter call as well. But we expect the material cost inflation to go down going forward and I think you've seen that in many other industries as well that would also support our gross margin development going forward.

And then the prices, as we mentioned and I think I mentioned it before as well, is that we have worked a lot with price increases across our product portfolio and our markets. And as we mentioned before, we expect that to kick in and have a positive impact in our last quarter, so in Q4. Yeah.

Mattias Vadsten
Analyst, Skandinaviska Enskilda Banken AB

Q

Yeah. I think that's perfectly clear and I will jump back on the queue but maybe to the prices. Can you comment anything how much you expect prices to help Solutions sales into next fiscal year? Because you said it will hit with more magnitude during the – towards the end of this fiscal year. So can you give any flavor there?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yeah. I think what we said before and what we keep too is on the Solutions side. I mean we have seen 3% to 5%, so mid-single-digit, low- to mid-single-digit as many other medtech segments as well. So that's what we expect on the Solutions side.

Mattias Vadsten
Analyst, Skandinaviska Enskilda Banken AB

Q

Perfect. Thank you so much.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Thank you.

Operator: The next question comes from the line of Oliver Reinberg, Kepler Cheuvreux. Please go ahead.

Oliver Reinberg
Analyst, Kepler Cheuvreux

Q

Oh! Yeah. Thanks very much for taking my question. The first one was actually be on China. So can you just provide a bit more color what kind of decline you have seen in China? When I look at the delta between the 4% and the 17% that you gave, I guess it points to a roughly two-thirds decline. Is that the right number? And if so, I would assume that also China has a kind of more stable service business, so if you can just talk about that would be helpful.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yes, of course. No. So there was a big impact on orders in China in Q2, not so much on revenue. We continue to install our revenue or our installations but the tender processes have been stalled or waiting to get clarity on a situation but, overall, it's around 50% down in China in the quarter. And we expect – as I also mentioned before, we expect a slow Q3 and then we expect Q4 to improve because we expect the tendering processes to come back. We also have many positive drivers with our partnership with Sinopharm with our Class A clarification on Unity as well as the investment plan for radiotherapy. So we'll continue to install and the orders will come back in the end of this fiscal year is what we see at the moment.

Oliver Reinberg
Analyst, Kepler Cheuvreux

Q

Perfect. Thank you. Just secondly on R&D capitalization and amortization, the capitalization was obviously moving up quite a bit now sequentially while amortization in fact sequentially have even declined. So, can you just talk to this and also is there a chance to get to kind of hard number what you expect in terms of capitalization and amortization for the full-year and also when you expect this kind of gap to close in which year?

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Absolutely. Hi, Oliver. Thanks for the question. I will start with a comment here about the development here. The capitalization, if I start with that, that is just following accounting standards, what to capitalize on and what not. In Q1, vacation periods are actually impacting the capitalization rate, and then aside from that it just follows the maturity of the project and the normal season pattern.

When it comes to the amortization and the development into Q2, that was actually finalization of all the one project of amortizing here so nothing in particular there as well. Therein – if we look ahead then and in terms of the hard number as you were asking about, we have about, if you look at the gross R&D as such again, according to plan, we will increase the gross R&D about SEK 25 million here to Q3. The amortization here will go up around also SEK 25 million while actually capitalization here will remain fairly stable between Q2 and Q3. And then you have consequently an impact here on the net R&D about SEK 50 million. So that is the math of it.

When you move down into the fourth quarter, we have a fairly stable development of gross R&D. And actually the amortization will remain about this level and capitalization might go down a little bit but be fairly stable. So that is the sequential development what we see from now.

Oliver Reinberg
Analyst, Kepler Cheuvreux

Q

That's very helpful and precise. Thanks so much. So can you just talk to when do you expect the amortization and capitalization to fully match each other? How many years will it take?

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

I think actually what we are saying is that and you see the current development that the gross R&D as a percent of sales, it's – have a healthier trajectory. The innovation pipeline is very important for us. It will generate a lot of value down the road but that is actually trending downwards. We will also have, as previously communicated as well, an uptick of amortization, so you will see those getting closer. We have not explicitly set a specific date for gross-to-net R&D but the quality of earnings is important for us and you see here the cash flow generation in

Elekta and also this, this is accounting, and we believe in the innovation pipeline and we'll continue to invest in that. But what you also see here in terms of the gross R&D is also driven by the nice sales growth that we have and improved productivity in that sense. So that is what we see.

Oliver Reinberg
Analyst, Kepler Cheuvreux

Q

Perfect. Thanks, Tobias.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Thank you.

Oliver Reinberg
Analyst, Kepler Cheuvreux

Q

The last question, if I may squeeze it in. On GenesisCare, any update?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yes. An update. So they came out just, what was it, a week or two ago with that they are going through the process and they got new funding so they will continue as GenesisCare also going forward. So we expect to have a dialogue with them to get more clarity exactly how that will be impacting us somewhere in the next quarter here. But, overall, a positive message.

Oliver Reinberg
Analyst, Kepler Cheuvreux

Q

Perfect. Thank you, both. I'll hop back in the queue.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Thank you.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Thank you.

Operator: Your next question comes from the line of Kristofer Liljeberg with Carnegie. Please go ahead.

Kristofer Liljeberg-Svensson
Analyst, Carnegie Investment Bank AB

Q

Thank you very much. Three questions. First, on the selling expenses, I noticed they are flat quarter-to-quarter despite the ASTRO Conference, so could you explain? And at the same time, I guess you should have had some salary increases kicking in. So does this mean that you continue to do some efficiency work on that cost line?

And my second question, coming back here to Chinese orders. Just wondering what your visibility is that orders will really be picking up again in the fourth quarter?

And then on – capitalized R&D has been discussed here. But my question just is as this also follows the development of the product, does this mean that you are nearing completion then on some larger R&D projects, or is it more of a quarterly volatility and the seasonality you talked about? Thank you.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

I can maybe start here with the selling expenses. I think – I mean here you were talking about the conferences. We had ASTRO in Q1. We have the ASTRO in Q2. Obviously, both of them are big events for us. I think in terms of general here, I wouldn't read so much about into the sequential development. We have, as you see here, crossover P&L been successful and actually create a distinct gap between revenue growth and the cost growth and that is important for us to continue structurally. Then I – you also see that we have a certain growth in year-over-year in selling expenses. And that is where we see an opportunity and we see the return. We will grab for that and generate more out of the investments that we do, regardless if it's CapEx or if it's R&D or if it's expenses. So that is what we see ahead of us.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yes. And on the China order and the visibility, I mean – as I mentioned Q3, we don't expect a strong development. But in Q4, I mean I was a week in China, a couple of weeks ago, and I discussed with many of our organization but also many customers and that is the expectations I get from those discussions. So we expect it to come back in Q4 in terms of the tendering processes and so on. That is the majority of the Chinese market.

The Chinese market is somewhere around 80% public volume. So that is a very important part of course to show growth. But I'm very much convinced that the need and the investments and the plans are there to continue to invest in the whole country in cancer care capacity, and also with our joint venture with Sinopharm. But also through our different partnerships with other players, we will be able to drive strong growth in China in the next years. On the R&D side, if there's a...

Kristofer Liljeberg-Svensson
Analyst, Carnegie Investment Bank AB

Q

Could I ask – sorry – on China orders, so could we expect then a massive pickup so that you will regain what you have – what has been on hold in both the second and third quarter or will this be more of a gradual, so maybe a small increase in China again in Q4 and then a larger increase into next year?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

I mean I expect a strong Q4 but it's difficult to know exactly how that would pan out for the full-year number. Of course, we need to get back to that when we have a better transparency. But we expect good order numbers there. But we'll get back to it in the next quarter and as soon as we know more.

On the R&D side, I think we have gone through – historically, as you know, we had Unity product. That was a huge product, project that we ran over many years and then we had a big increase in amortization during the period and then a reduction in capitalization. How we do our innovation products right now is it's a broader portfolio. It's more smaller releases of innovations every year, so it's kind of a different way of driving our innovation and product portfolio agenda. And we have been accelerating, as you know, and we have been launching a lot of product during the last two years and we'll continue to do that. So don't expect any specific big movement rather that we'll get out with a lot of innovations for the ESTROs and the ASTROs going forward.

Overall, the last year, and that was also part of the cost reduction program, we have been working a lot with the R&D efficiency and optimizing how we're driving our innovation funnel and we'll continue to do that as well. And you've seen that on the gross R&D numbers compared to last year's.

Kristofer Liljeberg-Svensson
Analyst, Carnegie Investment Bank AB

Q

Okay. Thank you.

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 the line of Hassan Al-Wakeel with Barclays. Please go ahead.

Hassan Al-Wakeel
Analyst, Barclays Investment Bank

Q

Hi. Thank you for taking my questions. I have three, please. Maybe to follow-up on the Q3 comment. Appreciate the comments on comps but could you give us more color on the degree of improvement that you expect in the second-half? Is mid-single-digit constant currency growth a reasonable assumption and how are the exit rates out of Q2 and into Q3? And what about the benefits accruing from pricing?

Secondly, can you talk about the orders and your expectations into Q3 given you've highlighted tougher comps? Should we expect negative order growth in Q3 returning to positive in Q4? And is this a function of China and how should we think about the other regions?

And thirdly can you talk about the improvement in free cash flow and working capital, which looks to be, in part, driven by improved advances? And how should we think about free cash flow in Q3 and Q4 given your commentary around gross margins and orders as well as the profile of customer advances? Thank you.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yeah. Yes. Thank you, Hassan. I think I'd like going to start a bit about the dynamics on orders into the next quarters and then Tobias can move into the cash flow.

But if you looked at where we are right now and revenue as well, I think the comparisons, especially on the revenue side, will be more challenging going forward because it's kind of the fifth quarter in a trend of really strong performance. We don't guide specifically on a number into the next quarter for the full-year but we continue, as we mentioned, to have the midterm outlook, more than 7%, and also to drive profit or margin expansion. And I think that's the ambition, of course, to drive revenue growth as well as margin expansion also into the next quarter.

If you look at then the order development, as mentioned China will show not so strong numbers. That's what we expect in the quarter. But for the rest, we see a good underlying demand. We see a lot of activity in many of the markets and that's what we expect from – to turn a lot of that into orders for the coming quarter. So I think that's the clarity we can give at this point in time and then we'll report out the next quarter.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Yeah. And coming to your cash flow question, you saw the improvement in this quarter. We will continue with this work. I think actually when you look at the different components, we do have both seasonality and the pace up of growth or at a bit higher inventory levels right now. We have also some payment terms, so successful deals in the Southern Europe where the billing terms were longer. So the work here with cash flow and working capital will continue and we see this on a positive note ahead of us.

Hassan Al-Wakeel
Analyst, Barclays Investment Bank

Q

Very helpful. If I could just follow-up. What impact do you expect to revenues either next year or maybe the year after from the order declines in China this year? Could it be more than a percentage point headwind to group growth?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

So, China was quite a quick order conversion, I will say that from order to revenue, so I don't see any big risks there. And then it's important to say the underlying need is there for both replacements and new capacity so I expect that to pick up. And you've also seen strong installation volumes throughout the last quarter but I also I will say for last year. And we also expect that to continue.

Hassan Al-Wakeel
Analyst, Barclays Investment Bank

Q

Okay. Thank you.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Thank you.

Operator: The next question comes from the line of Rickard Anderkrans with Handelsbanken. Please go ahead.

Rickard Anderkrans
Analyst, Handelsbanken

Q

Good morning and thanks for taking my questions. I have two, please. So, in Q1, you were quite clear that you aim for order growth for the full-year. I just wanted to confirm that this still remains the target and the clear ambition from your end so I'll start there.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

That's a good start, Rickard. Yes. We are driving forward to growth for the full-year.

Rickard Anderkrans
Analyst, Handelsbanken Q

Okay. Very clear. And then a question. So at the ESTRO Conference in 2022, you highlighted relatively big tenders in both Poland and Croatia. And as far as I can tell, these have not been sort of completed or materialized. And if that's the case, do you expect them to land during this financial year?

Gustaf Salford
President & Chief Executive Officer, Elekta AB A

Yes. There were some delays, especially in the Polish tender but we expect to know much more about Croatia very soon and then Poland a bit later.

Rickard Anderkrans
Analyst, Handelsbanken Q

Okay. But most likely within this financial year?

Gustaf Salford
President & Chief Executive Officer, Elekta AB A

Yes. Especially in Croatia.

Rickard Anderkrans
Analyst, Handelsbanken Q

Thank you very much. Very clear. Perfect. Thanks for taking my questions.

Tobias Hägglöv
Chief Financial Officer, Elekta AB A

Thank you.

Gustaf Salford
President & Chief Executive Officer, Elekta AB A

Thank you.

Operator: The next question comes from the line of Lisa Clive with Bernstein. Please go ahead.

Lisa Bedell Clive
Analyst, Bernstein Autonomous LLP Q

Hi. Thanks for taking my questions. Can you hear me okay?

Tobias Hägglöv
Chief Financial Officer, Elekta AB A

Yes.

Gustaf Salford
President & Chief Executive Officer, Elekta AB A

Perfect.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Hi, Lisa.

Lisa Bedell Clive
Analyst, Bernstein Autonomous LLP

Q

Okay. Great. Hi. Just two questions on Unity. First of all, could you just give us an update on the geographic split of Unity demand? And if there's any notable split between markets where there is more supportive reimbursement versus other.

And then also, on that note, can you just give us an update on some of the key findings from the MOMENTUM research consortium? And, historically, you're focused on getting separate reimbursement categories. Just where are you on that or is that sort of less of a priority today? Thanks.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yes. Thank you, Lisa. So, again on the geography of demand, so to say, and the MOMENTUM study. And then you had a second question, what was that? Sorry. Can I take it again?

Lisa Bedell Clive
Analyst, Bernstein Autonomous LLP

Q

Sorry. Those are my two questions. One, sort of, geographic split of Unity demand, and just two, any updates on the momentum research consortium and specifically if there's any movement towards sort of separate reimbursement categories?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Perfect. So if I start with the geographical demand patterns, I think it's a global trend and you see it ESTRO and ASTRO MR and RT, and MR Linac is really a big area both on the clinical papers and scientific research, but also in terms of productivity and how to drive more patient through, etcetera. So we see a big trend across the globe.

I would maybe highlight US at the moment because of ViewRay exiting that we have a lot of interest in that market for our technology with Unity because many of those sites and many of the leading institutions there have been treating with MR Linac for a long period of time and also see the big, big benefits.

On Elekta side and on the customer side we focus a lot on getting more patients through, increase the productivity because that's the key reimbursement driver, of course, number of patients going through the clinic per day. And there, we're seeing a very improvement trend over the last quarters, I would say, that's very positive because more patients get treated with this fantastic new technology.

If you look then more on the reimbursement side, I think throughput is the key driver for reimbursement when it comes to the clinic. But we also see a lot of discussions progressing on the unit through reimbursement or MR Linac reimbursement both in Europe. We have highlights in Japan, for example. We have a lot of discussions in China and parts of Europe and also the US takes a bit longer, but we have good discussions there as well.

But it's still with high throughput with the existing reimbursements it's still a very good often business case for those hospitals that is evaluating that technology.

If you look at the scientific evidence coming out and the clinical studies, they are becoming more of them, more output, more evidence. We see also that many of our partners and the clinicians, they are really taking it to new areas. If you look at the HERMES study going down to two fractions for prostate cancer. You see many examples in the US that instead of treating a patient for six to eight weeks, they go down to one week. That's dramatic improvement in productivity, but also the experience for the patient.

And we also see more and more of those papers coming out. We see papers on oligomers. We see papers on pancreas. We see papers on liver mets. So, it's becoming much more of a broad-based trend, also on the clinical side and also more and more papers and abstracts at ESTRO and ASTRO and JASTRO, for example, in Japan, that's happening this week.

Lisa Bedell Clive
Analyst, Bernstein Autonomous LLP

Q

Great. Thanks very much.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Thank you.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Thank you.

Operator: [Operator Instructions] Our next question comes from the line of Veronika Dubajova with Citi. Please go ahead.

Veronika Dubajova
Analyst, Citigroup Global Markets Ltd.

Q

Hi, guys. Good morning and thank you for taking my questions. I have three, please.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Good morning, Veronika.

Veronika Dubajova
Analyst, Citigroup Global Markets Ltd.

Q

Just apologies, wanted to circle – hi, guys. Want to circle back to the order of momentum for third quarter. And just if you could confirm whether you expect orders to grow in Q3 or whether you expect the China headwind to outweigh the growth that you're seeing elsewhere? That would be my first question.

My second question is just on your FX expectations for the gross margin for the second half of the year, given where we've seen currencies move to. And just maybe, Tobias, a general update on how currency is going to impact the second half numbers.

And then my final question is just looking at the business, obviously, you have seen – if I take the last four quarters, I think your order growth is still tracking only in the very low-single digit sort of 1% to 2%. And so, I'm curious if you can talk through sort of what gives you the confidence in sustaining that 7% sales growth if orders are only growing at 1% to 2%? And I'm not just looking at this quarter. I'm really looking at the last four quarters and on a rolling basis.

So, if you could help us think through what we might be missing in that translation, that would be helpful. Thank you, guys.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Absolutely. I'll start on the order side and Tobias will go into the FX. So, I'll take question number one and three here initially. So, China, we mentioned in orders for the next quarters, the impact. I think we don't guide on specific on orders. But one other driver, of course, is we had a really strong quarter in Europe last Q3.

So, that's a bit difficult comparison. But we see a strong performance in other parts of the world coming in. Exactly where we'll end up, we will not guide on that. But I think that would be the key two or three key themes that China, weaker; Europe, difficult comparison; rest of the world, stronger development, I think on the order side into Q3. That's what we see at the moment.

I think what you missed in the order equation, Veronika, is two things. It's the book to bill ratio, where we have had a strong book to build ratio, over 1, for a very long period of time. You also missed the order backlog, I would say, of SEK 46 billion that will support a strong revenue growth over the next year and years.

So, with those factors, I see that we have a strong support for our mid-term outlook of more than 7% revenue growth, together with a margin expansion. On the FX side, I leave that to Tobias.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Yes. Hello, Veronika. So, we can actually start to talk about the gross margin impact. We see slight negative impact from FX on gross margin here for Q3 and Q4. So, it's actually positive on revenues. It's a slight negative in terms of the gross margin impact.

And then, here, if you recall here from our financial statement, we had negative impacts here from the currency hedges here, also second half of last year. So, on an operating margin level, we will have a positive contribution from currencies. So, that's how it's played out with the current levels that we see right now, our currencies into the second half.

Veronika Dubajova
Analyst, Citigroup Global Markets Ltd.

Q

Very good. And can I just ask one follow-up quickly on China and sales? I just want to clarify your comment a little bit here. I think Siemens Healthineers have obviously guided given the short order-to-sales conversion to some headwinds to sales growth over the next couple of quarters from the weakness in China orders.

I'm kind of curious, I think, Gustaf, your answer to one of the previous questions suggested that you were not necessarily expecting that to be the case, but why wouldn't it be the case if you have a fairly short order-to-sales conversion if orders are down 50%, 60% for two quarters in a row, why wouldn't we see China sales down 50% to 60% for the following two quarters after that in terms of revenues?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

No. So, I think the order – say, if we're one to one half year between order to revenue, on average, for a Linac project, I think they will be able to catch up some of that effect. And I think the questions I got previously, I saw that more on a maybe rolling 12-months basis. So, of course, there could be some effect in a quarter on the revenue side for China.

But being there, talking to the customers, talking to many different partners here as well, I foresee that we can drive a strong revenue number also in China going forward. So, that's what we see at the moment.

Then, of course, when we have more transparency after Q3, we'll give an update there on China going forward as well. But what we see right now is strong installations going forward as well, strong opportunity on the Unity side in the next years. And also, that orders will come back in Q4 and onwards.

Veronika Dubajova
Analyst, Citigroup Global Markets Ltd.

Q

Okay. Thank you, guys.

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 the line of Robert Davies with Morgan Stanley. Please go ahead.

Robert J. Davies
Analyst, Morgan Stanley & Co. International Plc

Q

Yes. Thanks for taking my questions. I had just two, most of them have been covered. One was just if you could give me a little more color on just the APAC order trends outside of China. I think in the release, you called out some strengths in Australia and some of the other regions. Just be interested to get a bit more color in terms of what's going on there.

And then just the other one was tying into some of these questions around the medium-term growth outlook, I guess. Are you expecting sort of a wind down or a decrease in your backlog year-on-year from accelerating organic sales growth deliveries because I think a couple of people touched on the sort of run rates on orders? I think your book-to-bill year-to-date is 1.03. The order rates are sort of low-single digit. How are you going to get to that level without winding down the backlog? Is it fair to assume that organic growth is accelerating and your backlog is going down into next year? Thank you.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Thank you, Robert. If I start with APAC, I see that there's a good growth momentum, large unmet need. I mean, we talk about ASEAN countries. We talk about India. It's really, I believe, one of the areas with most growth potential around the world actually. Exactly the quarters and so on, we'll get back to that, but it is a good growth trajectory there.

On the backlog, yes, we have a big backlog and a lot of our initiative and priorities right now is to speed up the order backlog conversion into revenue as quickly as possible because the customers needs their products and solutions and service and that what we'll focus on.

The consequence of that will be that we will drive a lot and then backlog we'll see exactly what they end up on, but we want to install it as quickly as possible. I mean, and that could be a bit lower backlog then going forward. But of course, we also drive order growth around the world to fill the backlog. But I would say the big priority right now is to turn it into installed projects and revenue.

Robert J. Davies
Analyst, Morgan Stanley & Co. International Plc

Q

Understood. Thank you.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Thank you.

Cecilia Ketels
Head-Investor Relations, Elekta AB

Okay. I can see that there are no more questions. So with that, we would like you to listen in today. If you have further questions, don't hesitate to reach out later on and maybe some ending words, Gustaf.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

Thank you. Thank you, Cecilia. And, really, thank you to everyone for great questions or for – and for listening in to our earnings call. And as we said, we drove significant improvements and generated the fourth consecutive quarter with revenue growth and expanded EBIT margin.

But we also saw the order growth coming back and it's supported by large deals in both India and Ukraine. We also saw the cash flow improving in the quarter and we're really looking forward to continue to deliver on our strategy, ACCESS 2025, in the second half of our fiscal year 2024/2025. Thank you.

Cecilia Ketels
Head-Investor Relations, Elekta AB

And we wish you a great remaining day and see you on the road. Thank you.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

Thank you.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

Thank you.

Cecilia Ketels

Head-Investor Relations, Elekta AB

Bye-bye.

Tobias Hägglöv

Chief Financial Officer, Elekta AB

Bye-bye.