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Elekta AB (EKTAY.SE)

Q3 2023 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 Third Quarter 2022-2023. My name is Cecilia Ketels and I'm Head of Investor Relations at Elekta. With me here in Stockholm, I have Gustaf Salford, Elekta's President and CEO; and our CFO, Tobias Hägglöv, who will be presenting the results. And today's agenda starts off with Gustaf presenting some highlights of the development. And 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 these can include projections regarding revenue, operating result, cash flow, as well as product and product development. And these statements involve risks and uncertainty 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 joining the call. So, to kick off, during the third quarter, we continued to focus on the execution of our strategy, ACCESS 2025. And I would like to highlight some of the key and important initiatives we have been driving during the quarter.

We continued to invest in innovation with customer utilization in mind, and one of the key areas that is really driving ACCESS 2025 forward. We're focusing on the new linac platform, software development, and the Unity platform. And it was actually amazing to see that during this quarter, we also saw the benefits of our innovations reaching patients. The first patient being treated with advanced radiotherapy motion management using Elekta Unity or MR-Linac happened in Utrecht in the Netherlands.

And in the UK in Sheffield, the first patient ever were treated with our latest gamma knife system, Elekta Esprit. These moments are so rewarding for Elekta everybody working here, but also for customers and their patients. We are continuing to drive adoption and access to cancer care across the global scale and most recently by going direct into the growing Thailand market.

We're also drawing a lot of digitization and process excellence initiatives and our cost reduction program is progressing very well. It is vital that our strategy around ACCESS 2025 is delivered in a sustainable way and that we can measure and reduce our environmental impact. And a key highlight in the quarter was that we got our science-based target validated here just recently and I'll come back to that.

So, if we take a look at the markets and orders, we returned to a healthy order momentum growing orders were 9% in the quarter. In Americas orders increased by 3%, and both North and Latin America showed growth. The latter was driven by strong order intake in Mexico after winning multiple public tenders.

In EMEA, orders was flat compared to last year. Europe showed double digit growth on top of last year's strong growth and was driven by two big tenders in Spain and Italy that we mentioned before This slowdown was reported both in Middle East and Africa, but was really dominated by the Middle East due to weak markets in places like Egypt and Turkey as a consequence of their domestic macroeconomic situation.

In APAC, orders increased by 27% based on constant exchange rates during the third quarter. And the high growth in the region was explained by strong development in China, supported by public investments into the medical devices in the country. But it was also great momentum in Southeast Asia, both in emerging countries like Indonesia, but also mature markets like Korea.

During the last year, we have extensively worked with price initiatives across our business lines and regions to offset the impact from the higher component and supply chain costs. Price realization for new orders has shown good progress and we see that also turning into our P&L. We continue to also have a very strong order backlog of SEK 43 billion and this is really stable foundation for driving installations in the coming quarters across our regions.

And if we look at the installations and our revenue, their order backlog conversion has been a key priority in the third quarter and we delivered a strong revenue growth across all our business lines of 8%. The installation volumes in Americas and EMEA was strong resulting in double-digit revenue growth in these two regions. APAC was impacted by lower installations in China due to the wave of COVID cases in December and January. But we expect Chinese volumes already to recover in the coming quarter.

Americas grew with strong 15%. And it was in both in North American market and the US had a strong double-digit growth together with Latin America. EMEA grew with 16% and both Europe and the Middle East and Africa contributed with strong growth in the quarter. APAC came in at minus 3%. And that was really explained by the large impact from the COVID cases in China in December and January.

The recurring revenue service came in at 3%. And we had a strong Q2 with 7% the second quarter. And in the third quarter, installed base grew with 5%. So, at the end of the period, Elekta has an installed base of approximately 7,100 devices, of which 5,200 units were linacs, MR-Linacs and Leksell Gamma Knife systems.

And to support improved access to cancer care around the globe, we signed an agreement to acquire business assets from a current distributor in Thailand, Premier Business International. And with this local presence Elekta will increase the commitment to the Thailand customers while strengthening the position in the market with substantial further potential to improve and give access to the best cancer care.

And if we turn a bit to Elekta Unity and the paradigm shifting journey we're driving with the MR-Linac, you can see some of the evidence here. And if we look at prostate SBRT treatments, you can see that from our MR-Linac consortium is really driving this development and what's possible in radiotherapy. And if you take a deep dive into prostate cancer treatments, and this is a large indication, as you all know, you can see that there was a recent publication from the MOMENTUM study, and this is the largest study on prostate, and it's driving with five fractions, and it was analyzing the side effects. And this study shows that ultra-hyper-fractionated MRI-guided radiation therapy is effective and safe and the next step will be to move towards two fraction treatments with our MR-Linac Unity, which of course will dramatically reduce cost of care.

But there was also other key milestones for post-treatments with Unity. And in Australia, the St. Vincent Hospital, they have done the world's first simulation-free treatment ever, and this is a really big step in shortening the treatment time that is benefiting, of course, both the patients and the cancer clinics.

So, if we then turn another highlight of the quarter on the sustainability side, in February, we achieved official validation of greenhouse gas emission reduction targets and our science-based targets from the organization's science-based targets initiative. And this really means that Elekta's emission reduction targets has been validated to be ambitious enough to support the Paris Agreement and that our carbon reduction plan is aligned with climate science and really we need what we need to do going forward.

So, if we look into the different scopes and how we address them, for Scope 1 and 2, we have set two science-based targets. It is about reducing emissions by 46.2% from Scope 1 and 2 over the next 10 years. It's about transition to using 100% renewable electricity by the end of calendar year 2030. And if we look into scope 3, it is about cutting emissions from the use of Elekta products by 55% per radiotherapy treatment course over the next 10 years. It is also about engaging our suppliers to sign up for science-based target onto 2026 and 2027.

So with that update, I would like to hand it over to you, Tobias.

Tobias Hägglöv

Chief Financial Officer, Elekta AB

Thank you, Gustaf, and good morning, everyone. Now, starting with the Q3 financials. Total net sales increased by 8% organically in the quarter with strong installation volumes at the end of the quarter. Installations grew by 12% compared to last year. This was achieved despite continued challenges in the supply chain and fewer installations in China due to a large number of COVID infections. Geographically, we saw strong growth in the US and in EMEA. Our adjusted gross margin was 38.4%, an increase both sequentially and year-over-year.

Improvements were also seen in our expenses. Expenses in constant currency and adjusted for items affecting comparability decreased both sequentially and year-over-year, resulting in an improved adjusted EBIT margin of 10.7%. We continue to see a clear impact from FX in our P&L. Foreign exchange rates had a positive impact on our gross margin while being negative on the EBIT margin.

So let's look into our gross margin bridge. Our adjusted gross margin increased to 38.4% in the quarter to healthy net sales growth contributed positively with 320 basis points. Foreign exchange rates had a positive impact of 150 basis points, mainly driven by the strengthening of the US dollar compared to last year. The strong solution growth led to a negative mix effect impacting the gross margin by 100 basis points negative.

Looking into the supply chain, overall freight rates have come down, but we still have component shortages and inflation pressure from material and component prices. In total, the higher supply chain cost and inflation had a negative impact of 200 basis points.

Then looking into our expenses and in constant currencies and adjusted for items affecting comparability. All-in-all, the operating expenses decreased by 1%, both year-over-year and sequentially as we continue to see the results of our cost reduction initiatives. Selling expenses increased by 1% year-over-year in the third quarter, driven by more in-person meetings. Sequentially, our selling expenses declined by 6%.

Our administrative expenses declined year-over-year and was somewhat up sequentially due to investments in digitalization. Net R&D expenses declined year-over-year, but increase sequentially as we had higher amortization in the quarter.

So, let's look into our R&D spend in more detail. Gross R&D has declined sequentially from the peak in Q1 as previously communicated, sequentially capitalization decreased, whereas amortization increased in the third quarter. On a rolling 12-month basis gross R&D as well as net R&D declined.

Our cost reduction initiative has progressed well, and according to plan, our expenses are declining. During the third quarter, the initiative has reduced our spend by another SEK 70 million year-over-year, leading to a total reduction of SEK 120 million for the first nine months of this fiscal year. This leaves us well on track with the planned year-over-year savings of around SEK 200 million for the full year. At the end of April, we expect to have reduced the annual run rate of spending by SEK 450 million. As previously presented, SEK 150 million will come from COGS reductions, SEK 200 million for optimizing R&D spend, and SEK 100 million from lower selling and admin expenses. The year-to-date cost for implementing these cost savings amounted to SEK 263 million of which SEK 64 million impacted our gross income.

Moving over to the balance sheet. Our working capital has been impacted by strong sales growth by the end of the quarter. The buildup of inventories has been an act of choice of securing installations and managing supply chain challenges. The high level of shipments towards the end of the quarter generated an increase of receivables and accrued income from which we will get paid in coming quarters.

Then, looking to our cash flow. The EBITDA amounted to SEK 684 million in the quarter. The working capital buildup amounted to SEK 445 million, resulting in a cash flow from operating activities of SEK 225 million. Our continuous investments amounted to SEK 389 minutes mainly driven by R&D investments in the linac family and software to strengthen our product offering. All-in-all, our cash flow after continuous investments was SEK 163 million negative.

Now let's turn the slide and look into our financial position. Our net debt-to-EBITDA ratio amounted, by the end of the quarter, to 1.46. We have upcoming maturing debt in March which we have refinanced after the Q3 closing in February. Through this refinance, we have increased our available funds to more than SEK 3.9 billion and we increased our debt portfolio duration to 4.1 years. All-kin-all, we have a strong balance sheet and a solid financial position.

Over to you, Gustaf.

Gustaf Salford

President & Chief Executive Officer, Elekta AB

Thank you, Tobias. And now I would like to take you through the outlook. So, looking into the coming quarters, we continue to see an uncertain macroeconomic environment that we will be continuing. However, we saw in Q3 and expect going forward an improved order backlog conversion, supporting revenue growth. We have some component shortages still and we believe that inflation will remain and this is putting pressure on margins.

However, at the same time, we are driving the cost reduction initiative that's contributing positively that you have already seen. The long-term market trends is really supporting growth and investment in high-end radiotherapy equipment and margin expansion for Elekta.

So looking at the mid-term, the mid-term outlook until 2024/2025, it is unchanged. So we are having net sales count CAGR of above 7%, EBIT margin [ph] percent (00:17:23) expansion and a dividend policy of at least 50% of net income.

So to summarize the quarter, we see that demand for radiotherapy continued to improve in the quarter and supported our order growth. We managed our supply chain challenges well and could ship throughout the quarter. And we have a strong order backlog conversion driving installation volume and revenue. And we also see that the cost reduction initiative is progressing according to plan supporting profitable growth going forward.

So thank you for listening.

Cecilia Ketels

Head-Investor Relations, Elekta AB

Thank you, Gustaf. And before we open up for questions, I would like you to save the date at 20th of June. This is when we would like to welcome you all to our facilities in Crawley, which is close to the Gatwick Airport, for a Capital Markets Day. And more information about the agenda and the time will come when we move closer to the event, of course.

So let's switch over to the operator and answer your questions. Please, operator, go ahead.

QUESTION AND ANSWER SECTION

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

Mattias Vadsten
Analyst, Skandinaviska Enskilda Banken AB

Q

Good morning. I have a few questions. Probably take them one by one. First one, if you could maybe expound a little bit on the very strong orders in APAC, 27% year-on-year constant currencies, are there any particular drivers here in Q3 suggesting we should be cautious, or is it just really higher activity out there now particularly maybe in China? And then looking at the comp for Q4, both, last year and rolling over a few years, it looks quite similar. So just how we should think about it in APAC, really?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Gustaf here. So, yes, you saw very strong growth in APAC, 27%. The key driver was that the governmental programs in China in December, giving out interest-free loans to public hospitals, and the hospitals investing in cancer care, that results in new licenses. That was a significant driver of this growth. But we foresee that to continue because the Chinese market, as we mentioned before, throughout COVID, has been quite low on the order side. And now we expect it to go through investment cycle again. But it was not only about China, it was also, as I mentioned, before the Southeast Asian markets and Australia and New Zealand. But I think a key growth driver also going forward is China when it comes to orders. And we have a positive outlook for I would say APAC market activity and demand.

Mattias Vadsten
Analyst, Skandinaviska Enskilda Banken AB

Q

Good. Thank you for that. And in terms of the expected sort of supply chain improvements for Q4 you alluded to in the Q3 report. To what extent have you seen that already now in Q3 given margin expansion year-on-year already now and also with the solutions growth in the quarter? And how does your expectancy for Q4 affect back in November compared to what you see right now?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yeah.

Mattias Vadsten
Analyst, Skandinaviska Enskilda Banken AB

Q

That's would be my next point.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Oh, great question, of course. So, we had a very strong finish of the quarter. Logistic change has improved, ease to get sea freight. It's cheaper to get cheap sea freight as well. That's important for us. Airfreight the same. It's much cheaper. It's easier to get hold of. Road can be challenging, a bit costly still, lack of drivers and so on. But overall, there's been a big improvement and I foresee that to continue to improve going forward as well.

Then if you take the procurement, the manufacturing side, there are still components that's difficult to get hold of, for example, chips. And we work with that on a daily basis to get hold of them for our production, but I don't think that's something specific for Elekta, it's for the industry and many other industries as well. But if you take overall, I foresee that logistics chains and the supply chain will gradually improve going forward. And we saw a really good development here in the last month.

Mattias Vadsten Q
Analyst, Skandinaviska Enskilda Banken AB

Thank you very much for that. Maybe the last one for me before I jump back here, on the gross margin, I'm trying to set the tone aspects here, it looks quite strong given there is 51% of sales coming from solution, so could you maybe discuss the mix a little bit within installations, the installations you've done and how you see it going forward? Is it something we should keep in mind here?

Gustaf Salford A
President & Chief Executive Officer, Elekta AB

Yeah.

Mattias Vadsten Q
Analyst, Skandinaviska Enskilda Banken AB

That's my question.

Gustaf Salford A
President & Chief Executive Officer, Elekta AB

You saw in the bridge, I think that Tobias – and Tobias can add as well. But you saw in bridge that the solution service mix was there because we had a very high growth of solutions. But within that solution growth, there was a good product mix. So, that was quite profitable compared to the previous quarters. So, that always, as you know, changed quarter by quarter depending on what we install and deliver. But in this quarter, the solution product mix was favorable I would say.

Mattias Vadsten Q
Analyst, Skandinaviska Enskilda Banken AB

Thank you very much for that.

Tobias Hägglöv A
Chief Financial Officer, Elekta AB

Thank you.

Cecilia Ketels A
Head-Investor Relations, Elekta AB

Operator?

Operator: The next question comes from the line of Erik Cassel from ABG. Please go ahead.

Erik Cassel
Analyst, ABG Sundal Collier AB

Q

Hello. Good morning. Good evening as well. So, I just want to follow on on Mattias question. So, I'm thinking about how much we can actually extrapolate the strong margins in this quarter? I mean when we head into Q4 as you said, I would assume that there's still some cost pressures and supply chain issues. Maybe also more volumes going into China which would make solutions still a bit diluted than normal on gross margins. But is it fair to assume that deleverage from higher volumes can offset that dilution effect or is it rather more reasonable to expect gross margins actually coming down Q-on-Q into Q4?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Thank you, Erik. And a great question of course and let me break it down into the different components here. As we all know for Elekta, it's important with growth to get leverage on our gross margins. That's kind of a starting point but if you look into the gross margins, you will have inflation or material cost, component prices. Some of these components are difficult to get hold of. There would be higher prices of those.

But at the same time, you get leverage on the gross margin that's related to personnel like engineers or manufacturing workers and so on. So, we see a bit of that leverage going forward as well but I think the inflation will impact parts of our material costs. So overall, that's what we refer to in the outlook as well. There will be some of that cost pressure on the gross margins going forward.

And then it of course depends on how much growth we can drive from our order backlog in order to get that leverage we want on gross margins and then further down into P&L.

Erik Cassel
Analyst, ABG Sundal Collier AB

Q

But do you think those effects will rather now improve gross margins Q-on-Q or make them go down.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

I think it's important to say, I mean, as we always say but I would say to them that, I mean, we are driving for a revenue growth over to 7% and for EBIT margin expansion. So, that is true for the coming quarter as well.

Erik Cassel
Analyst, ABG Sundal Collier AB

Q

Okay. Thank you. Then I was just wondering if you could be a bit more specific on how much of the tenders in Italy and Spain you actually booked this quarter and how much is coming in Q4.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Yeah, we regarding the Italian deal, we booked a majority in Q3 here and we also booked some of the Spanish here. We do not provide explicit numbers on that. But that's how it looks like.

Erik Cassel
Analyst, ABG Sundal Collier AB

Q

Okay. Thank you very much.

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 Oliver Reinberg from Kepler Cheuvreux. Please go ahead.

Oliver Reinberg
Analyst, Kepler Cheuvreux SA /Germany/

Q

Yeah. Thanks very much for taking my question. The first one would be on China. So, can you just share any kind of color what kind of sales development you've seen in China in the first nine months? And any kind of thinking, how quick can there'll be a kind of recovery be it in terms of steepness when the market is not opening up? That will be the first question, please.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Hi, Oliver. So China, it's been, okay, I think installation volumes, but not on the growth trajectory over the last three quarters. But what we see right now is that the orders are coming back, better access to hospitals. There was a huge surge in COVID cases in December as was also in the news. But now we get very good access to the hospitals for installations going forward. So, we foresee that growth happening over the coming quarters in China to install a lot of linacs. The exact number for China for the third – three first quarters, I don't have that.

Oliver Reinberg
Analyst, Kepler Cheuvreux SA /Germany/

Q

Okay. Thank you. And the second question then on services. So, obviously, service growth was a bit weaker in what is normally a relatively stable business. And so can you just provide a bit more color what's happened here? And I assume that pricing was probably already a kind of support factor. And if you could quantify the kind of price effect in the service gross, please.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yeah. So, service as – our target is always to grow service more than installed base growth by adding value to the customers. We did that in Q2. There was a 7% service revenue increase. In Q3, it was 3%. Of course, we want to drive higher numbers there, but then you need to break down the drivers in the quarter, what it was. I think when you get growth in markets with greenfield installations that have a lower service contract pricing, even if you raise those prices, that will have a bit of an impact on overall service revenue growth. So, it's the market mix that in some quarters can have that impact. But over rolling 12 months, over the longer period of time, we always want to see that our service revenue growth should grow faster than our installed base growth. But that didn't happen this quarter.

Oliver Reinberg
Analyst, Kepler Cheuvreux SA /Germany/

Q

Perfect, then can you give us any kind of feeling on what was the net price support and service gross?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

I don't have the exact numbers, but I think on the pricing overall, we've seen on the solutions side that we have raised our prices and we mentioned that before, 5% to 10%. Then it's of course about price realization as well exactly what we get in the same situation.

On the service contracts, we always want to reflect the inflation in the specific country, so that is very different. They're often linked to CPI clauses, so that could be low than in APAC because the inflation is lower but higher in places like Europe and the US.

Oliver Reinberg
Analyst, Kepler Cheuvreux SA /Germany/

Q

Okay. Thank you. And then the last question, if we just take these kind of components, inflation, supply chain and pricing all combined, can you give us any kind of early indication how you think about these elements moving to next fiscal year? So, I guess pricing maybe is certain in that support, I guess in supply chain, there's a lot of improvements, and the offset is obviously inflation. So, any kind of color, if we take this combined before any kind of cost cutting?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yeah.

Oliver Reinberg
Analyst, Kepler Cheuvreux SA /Germany/

Q

Is it overall kind of the blend? Would it rather be kind of slight negative or even slide positive?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yeah. And great question, Oliver. And I think looking a bit further out, talking about the drivers again, then as logistics costs as a percentage of revenue, I assume that to improve, as it has already in this quarter going forward. So, that would be a positive driver. Material component shortages, I think that will improve if you take a 12 months horizon, but the prices are high because of availability. If you take the inflation, I think that's the most difficult part for all of us to evaluate exactly how that will hit on salary increases and component sales and so on. So, I think that we need to follow quarter-by-quarter how it develops.

And then overall, I think for Elekta to have the accessibility to our customers to do the installations, that's absolutely key to get the revenue growth so we can get the leverage on the gross margin. So that's just sharing my thoughts on those drivers that you were talking about.

Oliver Reinberg
Analyst, Kepler Cheuvreux SA /Germany/

Q

But any color – is that overall a kind of offsetting each other, or do you guess if we'd take this in isolation, we will [indiscernible] (00:31:31) next fiscal year.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Our ambition is to improve our profitability and margin expansion quarter-by-quarter. So the conclusion of that is a net positive.

Oliver Reinberg
Analyst, Kepler Cheuvreux SA /Germany/

Q

Okay. Perfect. Thanks so much.

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

Rickard Anderkrans
Analyst, Svenska Handelsbanken AB

Q

Great. Good morning. So thank you for taking my question. So first question on the contribution margin per region. So nice pick up quarter-by-quarter, 4 percentage points in both Americas and APAC. But that rather muted 1% quarter-by-quarter move in EMEA. And EMEA contribution margin has been significantly pressured. So how much of this contribution margin pressure comes from the tender activities? And is it reasonable to believe that EMEA can return to pre-pandemic contribution margins with these large tenders in the order book and delivery, so to speak?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yes, would be my short reply. But so if you look at the quarter, there is an impact when you have these larger deals independent of what region, country it is. You often get a bit lower average prices. Then you will earn that back on off to sales opportunities. It could be service contracts and so on. So I think that's important to say. And then overall, I say, we will drive good margins from the EMEA region going forward as well. But there is some impact from installations of the larger tenders in the quarter.

Rickard Anderkrans
Analyst, Svenska Handelsbanken AB

Q

All right. Thank you. That's helpful. And the second question, if you can elaborate a little bit on the sort of price realization and the overall margin profile of the large order volumes coming in from China. Now, do you sense any pricing pressure or margin challenges there? Obviously, value volume-based procurement has been a point of discussion in recent years, et cetera. So, it would be interesting to hear a bit more flavor on the margin dynamics in China. Thank you.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Yeah. So, margins in China, you shouldn't see China as a low margin market. They often want the latest technology, the best available cancer care treatment devices and so on. So, we have a strong margin position in China because of that. They want the latest technology. So, and I think I don't see that will change going forward. We have a huge need. I mean, linac for the population could be somewhere around maybe one and a half or two so a big need for more cancer care out in the different regions. And I think we will deliver that with a good margin going forward as well.

Rickard Anderkrans
Analyst, Svenska Handelsbanken AB
Q

Great. Thank you. That's all for me. Thank you.

Operator: The next question comes from the line of Julien Ouaddour from Bank of America. Please go ahead.

Julien Ouaddour
Analyst, Bank of America Merrill Lynch
Q

Hi. Good morning, everyone. Thank you for taking my questions. So, the first one assuming let's say so it's on orders. So, assuming a large part of the Italian tender was booked in Q3, let's say 75% according to my math it would imply that EMEA orders decreased by let's say, 20% at constant currency. Could you spend just a bit of time explaining what such a momentum like in this region?

Tobias Hägglöv
Chief Financial Officer, Elekta AB
A

Yeah. I can answer. Hello and good morning. I think first of all, when you look at I mean, this is an essential part of our business to participate in this deal. So, it's – whether to include or exclude it, but I think, I mean, yeah, we see a solid order development in Europe and that is also something that we see ahead as well.

Gustaf Salford
President & Chief Executive Officer, Elekta AB
A

A little bit longer perspective on that question. If you go back to Q3 last year, it was a really strong growth there as well from Europe. So, I mean, we showed two consecutive quarters year-over-year with strong growth and part of it came, of course, in this quarter from the larger Italian tender.

Julien Ouaddour
Analyst, Bank of America Merrill Lynch
Q

Okay. Okay. Thanks. Which means basically, excluding tenders, I mean, the – like the core business is not growing so much, right, like in Europe? I mean, that's mostly driven like by tenders, right?

Gustaf Salford
President & Chief Executive Officer, Elekta AB
A

The European market is a tender-based market to a very large extent.

Julien Ouaddour
Analyst, Bank of America Merrill Lynch
Q

Okay. Okay. Great. Thanks. Thanks a lot. Next question on EBIT. So, I just noted an important part of one-off in like the adjusted EBIT this quarter and a big chunk relates to impairment of facilities, and I think you didn't have it in previous quarters. So, just can you maybe also explain what it is exactly?

Tobias Hägglöv
Chief Financial Officer, Elekta AB
A

No, this is part of our cost reduction initiatives that we are looking for all cost and what we don't necessarily need to use, we shouldn't use it. So, it's actually – as we have gone through, I mean, for all other costs, this actually go through – I mean, building the facilities that we have, and what do we need to use and what we don't need to use. And so this is actually, it's a part of that, and it will also be one of the contributor for the cost savings ahead.

Julien Ouaddour
Analyst, Bank of America Merrill Lynch

Q

Okay. Okay. Great. Thanks. And maybe if I can squeeze the last one. You saw an uptick in installations toward the end of the quarter. Just how do you see installations in the next quarter, do you expect it to be up sequentially?

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

We are – we are positive as we also see an outlook that a good order backlog conversion also in the fourth quarter driving growth.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

And seasonally, as you know, and Q4 is our largest quarter.

Julien Ouaddour
Analyst, Bank of America Merrill Lynch

Q

Perfect. Thank you very much. Have a good day.

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 David Adlington from JPMorgan. Please go ahead.

David Adlington
Analyst, JPMorgan Securities Plc

Q

Good morning, guys, thanks for the questions. Maybe just a follow-up from Julien's on the European orders, I've done the same maths and I'm getting down to, to high-teens and into 20s in terms of ex, just the Italian order, never mind Spain. So, I just wanted to point out some macro headwinds in Egypt and Turkey, there seems to be a lot of headwind just in those two markets. But also, I suppose looking forward from here, if that is the headwind, do you expect those to resolve?

Second question is on cash flows, also a negative SEK 1.2 billion in the first nine months. Just wondered what your thoughts were on the full year outlook and how that might improve from here?

And then finally, just in terms of the capitalized R&D, I just wondered when that's going to become a headwind to margins as that capitalized R&D comes back onto the P&L. Thanks.

Gustaf Salford
President & Chief Executive Officer, Elekta AB
A

Thank you, David. So, one question on Middle East and Africa was my understanding one question on the kind of nine-month quarterly cash flow, and one question on capitalized R&D. But if I start with the Middle East and Africa question, yes, there is impact, of course, hyperinflation in both Turkey and Egypt and in parts of the other markets. So, it's not just those two countries. But in the region, you'll see some impacts on economic investment. You have high interest rates and so on. And I think that will not go away in the next quarter. But overall, of course, Middle East and Africa is a huge region and you have many economies that are investing in cancer care as well. But if you take the two biggest contributors in the third quarter, it was those two countries.

The nine-month cash flow, Tobias, maybe you can take that question?

Tobias Hägglöv
Chief Financial Officer, Elekta AB
A

Yeah. Absolutely. Good morning, David, and good to hear you. So, yes, to explain that we built the inventories, what the high sales growth towards the end of the quarter is what you see that this is actually converting into receivables, which we then will get paid here in coming quarters. So, that means that we are looking into a healthy cash flow here in Q4.

Gustaf Salford
President & Chief Executive Officer, Elekta AB
A

And then, there was the capitalization question as well.

Tobias Hägglöv
Chief Financial Officer, Elekta AB
A

Yeah. Could you repeat that, David?

David Adlington
Analyst, JPMorgan Securities Plc
Q

Yeah. Just wondering, [indiscernible] (00:40:47) the capitalized R&D continues to outweigh the amortization, just wondering when we're going to see a more normalization of that and what sort of impact we should be penciling in in terms of headwind for margins maybe next year?

Tobias Hägglöv
Chief Financial Officer, Elekta AB
A

Yes. So, actually, what you will see here is that the growth and the net R&D will gradually come closer here in the coming years. And in terms of the P&L impact into next year, you will see higher rate of the gradual increase of the amortization leading to a net impact on the P&L.

David Adlington
Analyst, JPMorgan Securities Plc
Q

And is that something you're able to quantify in terms of what happened to absolute R&D spend or percentage headwind on the margin or in things like that?

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Yeah. So, as said, what we have seen here is that the – in terms of the gross R&D that has stabilized. In terms of the gross R&D in percentage of sales, we expect that to continue to decline. In terms of the capitalization rate that is driven by the facing of the projects, it might be slightly lower. And in terms of the amortization, that will be a gradual increase so some extent on the P&L into next year but I wouldn't over accelerate it as well.

David Adlington
Analyst, JPMorgan Securities Plc

Q

Great. Thank you.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Thank you.

Operator: The next question comes from the line of Robert Davies from Morgan Stanley. Please go ahead.

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

Q

Yes. Thank you for taking my questions. The first one was just had on the backlog. You, obviously, mentioned higher levels of conversion in the coming quarters. Just if you could give us some sense of where pricing is sitting in the backlog? That would be helpful as the first question.

And then the second one was just on the competitive environment, I guess across the different regions. You obviously see quite high variability and different sort of orders trends in different regions. I just be interested to see if there's anything kind of material changing on the ground in terms of competition? Thank you.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Thank you, Robert. So, the backlog question, so, on average, our booking policy, we book orders three years if you get to multiple year order with – for service contract is five years. But on average for linac it's between one, one and a half year if you take MR-Linac with Gamma Knife into that range as well between order. And start of installation. So, most of it happened before a big part of it happened before. We did all of these price increases initiatives that we have done through, say, the last year or so. So, you will have some of the installations that were out now that was priced before for the inflation kind of kicked in.

And that's we're delivering right now. It's impacting a bit on the gross margins, but we see better price points going into the order backlog. And I think we have a good mix in the backlog to deliver in Q3, Q4 and Q1 and so on as well.

On the competitive side, I mean by market and so on, I think we are I mean seeing good development across the different markets for Elekta. If you look at the revenue side, we had a very strong Q3. I think that was a highlight for us compared to the competitive situation. So, I'm optimistic in I would say all our markets there. It's always different dynamics. We are strong in the say place like China, emerging markets and in Europe, parts of Europe as well. We have big opportunities, I would say, in Americas overall to take more share. So that's something, of course we are driving for.

But overall, I'm kind of optimistic that our model of being, really focused on cancer care, radiation therapy, together with strong partnerships in all these regions will really drive a good development for Elekta going forward.

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

Q

That's great. 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 last question comes from the line of [indiscernible] (00:45:31) please go ahead.

Q

Hi. Thank you. Sorry. It's [indiscernible] (00:45:39) I have three questions, if I may. The first is on the acquisitions of distributors in the emerging markets where we've seen you acquire over the last two years I think Egypt, Philippines, Malaysia, and now Thailand. Just I appreciate it, it's probably small investments, but just curious to understand accounting effects from these transactions. For instance, these distributors have any or did you have receivables outstanding to them in any way or did they carry inventory? And if so, how is that treated?

The second question is on service contracts. Curious could you elaborate and explain it if these include any – are they indexed to inflation in any way? And if so, what would have been sort of like-for-like growth in service orders?

And then the third question is looking at the filings from your German subsidiary, and I appreciate it's a small market, but it specifies that your market share there amounted to 35% last fiscal year, down from 57% three years ago. So I'm just curious, I know it's a small market, with this in any way specific to Germany or are we seeing the same trends in other developed markets? And how do you expect to claim that? Thank you.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Thank you. Thank you for those questions. I think on the – when we go in to new markets and like, as you mentioned, Egypt there. We have done it in Mexico. It's Thailand, of course. It's Indonesia. The key thing there is that when a market becomes, say, around 30, 40 of an installed base, that's a good time for Elekta to enter because we have installed base to work with. We want to become closer to our customers. We want to service them and connect them to the wider kind of Elekta. And then, we often acquired assets or the company in that country from the distributor because they have built up that market, of course.

So, accounting wise, then you will get more service revenue because that's the key thing. We have solar products into those markets, but it has been the distributor that had the service revenue. So, that's often a good business case for us to then acquire. We get profitable service revenue, and we also get growth. And the key thing is that we also come closer to our customers. So, that's kind of the strategic background, and it's often a good investment case as well for Elekta and why we go into new markets.

On the service order side, and I think I said that already earlier in the call, that in most of our service contracts, we have what we call CPI clauses that's linked to inflation in that specific country. And then that will be added once a year when you review the CPI development in that specific country. So, it varies country by country what the levels are.

On the Germany disclosure, I need to take a look exactly on those numbers that you were showing, but I think it's not an indication for the overall European market share or anything like that. That's quite stable. And I would say, [ph] Mattias, (00:48:56) if you take a look in this industry on the market share developments year-over-year, they are quite stable, but they will of course fluctuate a lot if you take a small market in relation to the total sales of Elekta like Germany and do that analysis. So, I think you need to look at regional level or global level to really understand the market share development.

Tobias Hägglöv
Chief Financial Officer, Elekta AB
A

And I can also just add here on general point here that, I mean, doing these acquisitions in general is asset light. So, it's – yeah, just a comment there as well.

Q

Okay. Many thanks.

Gustaf Salford
President & Chief Executive Officer, Elekta AB
A

Thank you.

Tobias Hägglöv
Chief Financial Officer, Elekta AB
A

Thank you.

Operator: We have a follow-up question from the line of Erik Cassell from ABG. Please go ahead.

Erik Cassel
Analyst, ABG Sundal Collier AB
Q

Thank you. So, I just have a follow-up on the market share comment that you just did and on that being stable over time. I mean, your key competitor is guiding for 9% to 12% growth in 2023 based on a good macro environment. But is there anything in the competitive dynamics that make you think that you could potentially lose market share in 2023?

Gustaf Salford
President & Chief Executive Officer, Elekta AB
A

No. I mean, I shouldn't comment on our competitor's guidance if I start there. But I – we guide for more than 7% on the revenue growth. But I don't see any big changes in that competitive dynamic or the market share and so on. I think we have good opportunity to grow our market share in many markets. So, that's kind of what I would like to add to that question.

And then I think comparing, it's more and more difficult to compare us with competition because they're part of a larger international company as well as they are going into areas where we are not part of as well. So, we are really, really focused and that is our strategy, to be focused on radiation therapy with strong partnerships. So, it's – you need to take that into account as well when look at growth rates.

Erik Cassel
Analyst, ABG Sundal Collier AB

Q

Okay. Thank you very much, Gustaf.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

A

Thank you.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

A

Thank you.

Cecilia Ketels
Head-Investor Relations, Elekta AB

And if there are no more questions, we thank you for calling into this presentation. If you have further questions arising during the day, please do not hesitate to reach out to myself or us here at Elekta. And with that, we wish you a good remaining day. Bye-bye.

Gustaf Salford
President & Chief Executive Officer, Elekta AB

Bye-bye. Thank you.

Tobias Hägglöv
Chief Financial Officer, Elekta AB

Bye-bye. Thank you all.