Corrected Transcript

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Storskogen Group AB (STOR.SE)

Q4 2023 Earnings Call

CORPORATE PARTICIPANTS

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Lena Paulina Glader
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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Storskogen Q4 Presentation. [Operator Instructions]

Now, I will hand the conference over to the CEO, Daniel Kaplan; and CFO, Lena Glader. Please, begin your meeting.

Daniel Samuel Kaplan
Co-Founder & Chief Executive Officer, Storskogen Group AB

Hi, and welcome everybody to Storskogen's presentation of the fourth quarter and 2023. My name is Daniel Kaplan. I'm the CEO. And together with me, I have our CFO, Lena Glader.

So let's jump straight into it, the highlights. Starting with the quarter, SEK 9 billion in sales, SEK 706 million in EBITDA, and an EBITDA margin of 7.8%. Reasonably happy with sales. The decline is mostly attributable to divestments. The EBITDA margin, however, I'm particularly happy with facing some margin contraction in trade with weak Christmas sales and weak consumer – and consumer demand. And in Services, we also saw both some cold weather, which makes it cumbersome for our infrastructure companies to deliver, but also a weak sentiment in the new construction-related segments.

So, not super happy with the fourth quarter, in that respect. What we are happy with is, of course, the cash flow in the quarter, super strong, almost SEK 1.5 billion. Quite extraordinary. And we were very happy with that. And we currently have an LTM adjusted cash conversion now far beyond our target of 70%. So, we're reaching 104% now for the last 12 months.

Looking at the full year, we have a SEK 36 billion sales, 5% increase and EBITDA of SEK 3.2 billion, which is a 3% increase and a margin of 9.0%. I think given the complex environment, especially on macro, weak consumer confidence, high interest rates, et cetera, I think we are reasonably happy with this. I think we have done a lot of work to protect our margins and our market shares, keeping sales up and margin decent at least. Once, again, what we're really happy with was of course, our key strategic priority, the cash flow, generating about SEK 3.36 billion in the year. So, very happy with that.

And of course, we used that money to our second strategic priority, which is to reduce debt with a more than SEK 800 million in the quarter and SEK 2.8 billion in the year. So, I think that's been very important for us, of course, at this point. Organically, we have been struggling this year, sales minus 3%, EBITDA minus 13%, margin contraction. Weak consumer confidence, once again, and also a softer construction-related segments. We have basically done no material M&A activity in quarter. The board proposed the dividend of the SEK 0.09 per share, a slight increase.

So, going forward, looking more in depth on net sales and EBITDA margin. Here, you can see our seasonality effect, basically sales is basically on par with the comparable quarters. But as we mentioned before, a margin contraction. So, looking at 2022, which is a better proxy for our normal seasonality and also what we are actually – this is very early in the year and of course, with the caveat that we don't know. This is the seasonality that we were expecting. Basically, a weak first quarter; also, the third quarter is usually a somewhat weaker and stronger second and fourth quarter. This is what we are expecting if everything turns out as normal because, of course, this year that we had, we had a quite an extraordinary Q1 and a weak Q4 as you can see here. And looking also the divested companies sales of SEK 559 million in the comparable quarter as we said.

All right. Moving forward. So, how have we delivered to the strategic priorities that we set out in the Capital Markets Day a little bit more than a year ago in September 2022? But I think the most important was, of course, to improve cash flow. We had lots of newly acquired companies in the portfolio and it was quite evident that most of them had never, ever worked with cash flow. So, we'll get into how we managed to do this. But I think this is an area where we're very proud of our performance. If we're looking at the operating cash flow defined as the adjusted EBITDA minus the change in net working capital minus CapEx, we actually achieved SEK 4.5 billion in 2023, which is, of course, very strong.

When it comes to protecting profitability, we have done a number of activities. The bottom line there, we have reduced negative EBITDA effects from group operations. We did cost cuts already in 2022. We actually did a second round of cost cuts in our central group operations here during autumn. So, when we were geared for a faster growth, our peak cost to sales, central cost to sales was actually 1.2% with almost 117 people. We're currently down to approximately just about 80 full-time employees and the 0.7% of sales. I think this is a level where we're quite happy. I think we can support our companies with active ownership. We can help them in all kinds of ways and also support our geographies in a proper way, but still not geared for the rapid acquisition pace that we had previously and that we don't foresee going forward.

Also on the – if we're looking at the portfolio level company, which is even more important, we have done some significant cost saving initiatives in some of our low performers, especially the Trade area, reasonably happy with 9%. I think we are geared for when the business cycle turns, I think most of our companies will be lean and mean, so to say, going forward. So – but of course, with the negative organic growth, we need to keep tabs on our costs to protect our profitability as well.

Reducing leverage, I think, the key objectives of reducing leverage is, of course, to reduce interest rate costs and to reduce refinancing costs. I think we have certainly reduced our debt. We've done the work. We reduced debt in one year with SEK 2.8 billion in 2023, primarily through cash flows, but also through some divestments. We're very happy with that. And our interest-bearing debt cost has, of course, had a significant decrease. And also our refinancing risk has been managed through a new bond release as you might know, earlier in the year. And you can see our bonds are trading at better prices now or tighter. So, I think we're there, but we're not – when it comes to the leverage ratio, we're still not there and we still have an ambition to move down towards the lower end of the spectrum, 2 to 3, where our target is. So we're not there yet.

Reduced M&A pace. We have been – it says here 12 acquisitions, but actually it's only been 2 platform acquisitions. Most of those have been very small strategic add-on acquisitions, with basically no material effect. On the other hand, we have done a significant divestment. 11 strategic divestments completed in 2023, contributing with cash, but also gradually improving the profile of our portfolio. So, the acquired companies significantly higher margins, return on capital employed as compared to the divested companies.

So moving ahead, well, cash flow, that's what I mentioned previously. A strong increase in cash flows from SEK 1.6 billion to SEK 3.36 billion in the fourth quarter and rather in the LTM. So, we're very happy about that.

And the way we've done this, if we move to the next page is to – we've been very, very systematic. We started offsetting an internal target of reaching our net working capital to sales of 15%. We started off by educating our companies, why is net working capital something that we want to keep tabs on? Why is it important? We started to help them interact with each other, share best practices. We introduced various analytical tools. We set targets. We started to follow up and benchmarked against each other.

And just this other week ago, we had a CEO event with 114 CEOs in place here in Stockholm. They told their stories of the year that passed. It was really heartening for us to have been working hard to see that they're really taking the working capital work to heart, that they have changed their behavior. And it's also something that they never worked with before. We heard that from even some of our very best CEOs that this was a new thing and they've really made some great improvements. And hopefully now, not only that, we've renegotiated terms and increased billing frequencies and reviewed stock levels, et cetera. I think this has resulted in a long-term structural change in how our companies behave going forward.

So, feeling comfortable that we can remain on a decent level with regard to working capital going forward. We're not guiding on results for next year, but we can say that we believe that we will have strong cash flows even in the coming year – even though, of course in the long-term we're guiding towards a 70% cash conversion. So over time it should converge to that. But in the next year, we foresee continued strong cash flows.

Looking ahead to next page, we're actually now we're doing what we can on cost. We're doing what we can on working capital. And those are probably our key objectives initially at least. However, we have continuously during these years kept our CapEx at a consistent level supporting our companies with new investments in machinery and factories, et cetera. Basically to set the stage that we can take market share and accelerate when the business cycle turns. If you look at the organic sales growth here, it's a minus 4% in the COVID 2020. The bounce back in 2021 with 17% organic sales growth and a decent sales growth even in 2022, whereas we've had a negative sales growth now in 2023. But nevertheless, we've kept our CapEx levels relatively steady.

One example of this is actually one of our first acquisitions, IMS Maskinteknik, this is in Enköping, a relatively small company in our world. It's a contract manufacturing company, it's delivering primarily to the aviation industry its prototypes. It's basically heavily – heavy metal workshop, and small series. And we noticed that we had basically reached our maximum capacity in 2019. So what we did was we actually rebuilt the factory. We enlarged it quite a lot. We acquired multitasking machinery to better respond to our customers need. And this was, of course, given the turnover, as you can see in 2020 with SEK 40 million, we spent quite a lot, also heavy investment compared to that turnover. But the results have first of all resulted in stronger customer relationships. We also managed to partly diversify our customer base, reducing the risk of a single customer leaving. And as you can see, the results have been quite tremendous here with almost a 20% margin in 2023 and a good outlook as well. And this is testament to the work that we have been – we are doing in a lot of our companies, that will hopefully enhance growth going forward.

So, looking at the next page. So, how did we perform in the quarters? A brief comment on all three business areas. Services was actually a disappointment in the quarter. We saw that some of our segment, this is Engineering Services and Infrastructure. Engineering Services primarily due to the weak construction business cycle. Infrastructure also had a weak development, partly because of the cold weather actually making it difficult to dig when you have tjäle, that's in Swedish, frozen ground basically, HR & Competence, some of our competition in that vertical have their Swedish employment agency as their main customer and that is a complex environment to handle.

So, these three, Engineering Services, Infrastructure, and HR & Competence were the disappointments of the quarter, whereas Digital Services and Logistics continued with solid performances. Sales almost SEK 3 billion in the fourth quarter, but still a negative sales development. The adjusted EBITDA SEK 257 million and this was of course a minus 30% compared to the previous quarter. I should say here that we have divested companies in the Services arena, sales of SEK 377 million in the comparative quarter. So, that of course, really contributes to the decline, but nevertheless not a satisfactory fourth quarter for Services.

Looking at our next business area, Trade. Well, this was more expected. We had margin pressure, very strong working capital release, very positive sales of SEK 2.5 billion, a total of SEK 10 billion in the year, with a significant decline in adjusted EBITDA in the fourth quarter. Weak Christmas sales. I think the entire year has been characterized by destocking in the value chain, including with our companies, of course. So the weak consumer confidence and demand, together with that, the double whammy, you might say with most players, our customers basically destocking has been a significant impact.

Looking forward, we're not giving guidance to the coming year, but we can see with the exception of Q1, which we expect to be seasonally weak. We do see actually somewhat stronger order books for those companies that have order books going forward. And also, when we ask our own companies about their stocking situation, they're quite happy. They think they are on a decent level. And as a proxy for the market as a whole, we do believe that the value chain basically has stabilized, which will make things easier in the coming year. The strong cash flow, very good at decreasing inventory levels, I think, to a great extent. I should say not all companies here are struggling. Looking at the vertical Health and Beauty, for example, they are truly delivering on the lipstick index, so to say, being very resilient in this market and delivering strong results.

Yes. Going forward to Industry. Industry had a fantastic 2022, continued with a strong 2023, I should say. Net sales have increased to SEK 14.6 billion, SEK 14.7 billion in the year and SEK 3.55 billion in the fourth quarter. It was nevertheless on margin a somewhat weaker quarter. And we saw some decline in the order books for some of our big companies. However, looking a little bit more forward-looking, I think we can see that those order books have stabilized. In fact, these last weeks we have actually received a number of very big orders. So, a more stable outlook for Industry. And they also don't really have the same seasonality as Trade and Services when it comes to the quarters. So, a decent performance from Industry, both historically and going forward, hopefully.

Yes. I should say strong verticals here in the quarter. Automation and Industrial Technology still being supported by the reshoring trend, Green transition and also strong demand for Automation Solutions.

Yes. So, we're moving forward. Lena?

Lena Paulina Glader

Chief Financial Officer, Storskogen Group AB

Thank you, Daniel. So let's have a closer look at the Q4 financials here on this page. Net sales growth, as Daniel said before, with minus 9% and SEK 9 billion, impacted by organic growth, M&A and currency. And I'll come back to that in more detail in just a few minutes. Gross margin in the quarter improved by 1 percentage point from 19.7% to 20.6%. Gross margin increased by 4 percentage points in Industry, was around flat in Trade and decreased by approximately 3 percentage points in Services, meaning that we were able, on a group level to meet higher cost of goods sold inflation with higher prices. But, however, softer demand, particularly in consumer segments and new construction segments, as you mentioned, Daniel, coupled with somewhat higher SG&A

expenses, again, a result of inflation and lower other operating income meant that we saw an EBIT decline of 34% to SEK 520 million in the quarter.

Items affecting comparability were lower, SEK 29 million in the quarter compared to SEK 87 million a year ago. And this, of course, affects the reported EBIT growth slightly negatively. And what we show here, obviously is non-adjusted numbers, bear in mind. Increase in net financial items is obviously a result of the higher base rates compared to a year ago. Since our interest-bearing debt in absolute terms was 18% lower than a year ago, but interest expenses did nevertheless decrease quarter-over-quarter compared to the third quarter, amounting to SEK 225 million now in Q4 from SEK 257 million in Q3. And then finally, earnings per share SEK 0.06.

Now, let's have a quick look at the full year financials on the following page here. Full year net sales growth was plus 5% to SEK 36 billion. And, again, I'll come back to a more detail drill down of the effects from M&A and organic growth and currency on a separate page in just a little while. Gross profit for the full year increased by 8%. So more than sales growth, again, showing that we were able on a group level to compensate inflation in cost of goods sold with higher prices. For the full year, however, SG&A expenses increased in line with gross profit by approximately 8% as well, but lower other operating income and expenses explained by items affecting comparability and currency all explained in our financial reports, led to a decline in EBIT of 6% for the full year. Net financial items increased sharply due to higher base rates in the full year, obviously, despite substantially lower debt, leading to a 37% decrease in profit before tax to SEK 1.3 billion.

Earnings per share for the full year was SEK 0.47 before and SEK 0.46 after dilution. And the dividend as you mentioned before, Daniel, proposed by the board is SEK 0.09 per share. Return on equity was 4.6% for the full year, obviously explained by higher financial costs. And return on capital employed was 7.7% and return on capital employed, excluding goodwill was 17.4%.

On the next page, we show a full year bridge of sales and EBITDA. And starting with the sales bridge to the left, you see here that Services had a more or less flat sales growth. Trade had a slight positive growth, but the largest contribution came from Industry, with SEK 1.4 billion higher sales compared to 2022. And the corresponding EBITDA bridge to the right there, shows that Services and Trade decreased somewhat in EBITDA, whereas Industry contributed positively again and also group operations due to lower costs at head quarters.

And on the next page, we're looking more closely at sales developments, slicing it in another way here. First, starting with the contributors for the fourth quarter, where you see that organic sales growth in the quarter was minus 5%. We had slight positive contribution from currency and acquisition of 2% in total and minus 6% is our contribution from divestments. And a similar bridge for the full year shows that organic sales growth was minus 3%, currency at plus 2%. Acquisitions contributed with 10% growth, where only 1%, however, relates to acquisitions made in 2023 and the rest relates to acquisitions made in the previous year. Divestments contributed by minus 4% in the full year.

And then, over to cash flow statement for the fourth quarter. Our focus on cash flow is obviously yielding significant results as shown here. Change in net working capital contributed plus SEK 692 million. This is thanks to significantly reduced inventories and receivables, somewhat offset by lower accounts payable. Cash flow from operating activities after interest and tax was closer to SEK 1.5 billion in the fourth quarter and closer to SEK 3.4 billion for the full year. And then cash effects from M&A, including earn-outs and minority payments, was minus SEK 60 million in Q4 and just short of SEK 400 million for the full year. And this is a net of acquisitions, divestments paid earn-outs and acquired minority shares in subsidiaries. And I'll come back to cash conversion and change in debt shortly.

So, on the next page, we have cash conversion, which is obviously one of our financial KPIs for the group target of at least 70%, which is the dotted line here. The rolling 12-month cash conversion has, as you see here, improved every quarter from Q2 last year, thanks to great work by our subsidiaries, as Daniel explained, in reducing inventories and receivables. And we reach 104% cash conversion for the full year, 154% for the isolated fourth quarter. We reached a net working capital to sales target of 15% by the end of Q4, which was an internal target for the year. And as Daniel explained, we believe this is a sustainable level, but there's still a lot of ongoing long and short projects to maintain the working capital efficiency. And then working capital is obviously one of the large contributors to the strong cash flow.

On the next page, we show a cash flow bridge for the full year. The previous page related to Q4 only. Cash flow from operating activities, after significant positive contribution from change in working capital was SEK 3.36 billion. CapEx was SEK 610 million, 1.7% of full year. IFRS leasing, which is obviously not defined as operating according to IFRS, but in reality it is operational has the larger part, approximately 80% of this is rental costs was SEK 563 million or 1.6% of sales. Free cash flow after leasing, calculated this way was SEK 2.22 billion for the year, which is a year-on-year improvement of SEK 1.7 billion.

M&A activities amounted to a total of SEK 200-plus, a positive SEK 245 million. And then earn-out payments related to previous year's acquisitions were SEK 636 million in the year, but will be significantly lower going forward. We will, however, have some minority shares that we will buy back likely during this year. But bear in mind, acquiring minority shares also improves obviously EPS.

This means that cash flow before dividend and change in loans amounted to SEK 1.83 billion. And then, how have we used this money? Well, on the next page, we have a closer look at the debt and leverage development. Here on this page, we show the development of our debt and cash balances quarter by quarter. And the dotted line there is the 12-month pro forma EBITDA, which is used in our leverage definition.

To summarize here, total debt was reduced by SEK 3.5 billion during the year. Interest rates have gone up in parallel to our debt reduction. But as of Q4, we're starting to see lower interest costs, as I just previously said. Our interest-bearing debt consisting of the blue bars, which is interest-bearing – well, which is, in other words, bank loans and bonds, plus the light brown bar, which is leasing and pension provisions, was reduced by SEK 2.8 billion during the year. Non-interest-bearing debt, earn-outs and minorities was reduced by SEK 731 million in the year. But in the fourth quarter alone, interest-bearing debt was reduced by SEK 814 million and liabilities for earn-outs and minority options by SEK 91 million. And obviously, we've used our strong cash flows, which was as shown on the previous page, SEK 1.8 billion, as well as cash at bank to do this. And when it comes to liquidity, cash and cash equivalents at the end of the year, the yellow bars south of zero here on this chart, total SEK 1.6 billion, plus unutilized credit facilities in total SEK 6.6 billion.

And finally, on the next page, we have the Storskogen Group's condensed balance sheet for the end of December. Total balance sheet is 7% lighter than a year ago, and this is largely explained by divestments, as well as lower working capital, which has enabled us to reduce our debt. Equity, on the other hand, has increased by 4% and the equity ratio hence increased to 46%. Interest-bearing leverage was reduced to 2.5 times during the quarter. Our ambition remains to bring leverage to the lower end of the 2 to 3 times range, but as seen here and on the previous page, adjusted RTM EBITDA came down year-over-year to SEK 4.3 billion because of divestments, but also negative organic profit growth. And this meant that our goal was not reached during the quarter despite the significant debt reduction.

Looking ahead, existing cash and expected solid cash flows also in 2024 means that we can continue to further reduce debt in absolute terms, not least in order to further lower our interest expenses. However, in terms of the leverage ratio, bear in mind that we will be rolling out a fairly strong Q1 last year, as Daniel showed on the previous page, and expect to be rolling in Q1 with more typical seasonality.

So, to summarize, I guess, it was a busy and fruitful year in regard to improving cash flow and reducing debt. But that said, we're not yet at the level where we want to be, but we're a little bit closer, aren't we? So over to you, Daniel, for concluding remarks.

Daniel Samuel Kaplan

Co-Founder & Chief Executive Officer, Storskogen Group AB

Thank you, Lena. So, in conclusion, we're not happy with the margin in the fourth quarter, but looking on the full year, we are quite happy with the cash flow and our hard work there that has yielded strong results, both this year and the previous year, but also going forward. I think we've set the scene for strong cash flows going forward. I think we have significantly reduced debt and made some headway on that.

Looking forward on our priorities going forward, the continued focus on cost control in our companies and also HQ, I think we want to reduce debt. We want to reduce refinancing risk as well, even though that has been managed quite well so far. We're also gradually looking ahead and I think we're doing more and more shifting towards initiatives driving organic growth. So I think that will probably come forward as the key priority later in the year.

So thank you very much so far. Let's get on with some questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] The next question comes from Johan Dahl from Danske Bank. Please go ahead.

Daniel Samuel Kaplan

Co-Founder & Chief Executive Officer, Storskogen Group AB

A

Hi, Johan. We can't hear you.

Operator: Johan Dahl, Danske Bank. Your line is now unmuted. Please, go ahead.

A

Sorry, moderator, here. Johan, is your line muted on your end?

Daniel Samuel Kaplan

Co-Founder & Chief Executive Officer, Storskogen Group AB

A

We can hear now, Johan, by the way.

A

No. This is [ph] Jonathan (00:34:57), the moderator. I'm just checking if...

Daniel Samuel Kaplan
Co-Founder & Chief Executive Officer, Storskogen Group AB

A

Okay.

A

...Johan's line is unmuted on his end. Okay. Sorry, Johan. We have to move on.

Operator: [Operator Instructions] There are no more questions at this time. So I hand the conference back to the speakers for any closing comments.

Daniel Samuel Kaplan
Co-Founder & Chief Executive Officer, Storskogen Group AB

So, thank you very much for listening in. If you have any questions to us, don't hesitate to call. I would be happy to answer. And have a wonderful day. And thank you...

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

Thank you.

Daniel Samuel Kaplan
Co-Founder & Chief Executive Officer, Storskogen Group AB

...from us. Thank you very much. Bye.