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Nolato

Q2 2019



Prepared Remarks



Hello, and welcome to the Novarto Q2 Report 2019. Today, I am pleased to present CEO, Christoph Walt Christ and CFO, Per Olav Holmstrom. I will now hand you over to Christoph Waltz. Please go ahead.



Thank you, and welcome, everybody, to the presentation of Mulatos' Q2 2019. I will start on Page 2 with the Q2 summary for the group. And in the Q2, we had sales that totaled close to 2,000,000,000 a high comparison number. That was SEK 2,300,000,000 last year. Adjusted for currency and group structure, that means the sales decreased by 17%.



We saw continuously strong performance by Medical Solutions. We saw normalized inventory situation at Integrated Solutions, and we had inventory adjustments affecting Industrial Solutions. The profit, EBITA, decreased to 2.33000000 compared to 266 euros That gave us a strong margin of 11.7 percentage. Cash flow of investments amounted to 178,000,000, and we still have a continued solid financial position. I'm now turning to Page 3 in the presentation.



Of course, we have the Renate Group consisting of 3 different business areas. And in common for those, we have, of course, the same corporate responsibility. We use the same material technology, and we are working as solution oriented development partners, and we share the same technology on the production equipment side. But of course, the business areas are very separated in the market segments they are addressing, but we see that we get a lot of synergies between the different areas that we are working in. Now jumping to Page 4, starting with Medical Solutions.



In the second quarter, we had sales of €634,000,000 and EBITDA of €82,000,000 giving a margin of 12.9 percent. You can also see that, that is again record for us, which we have seen now for close to 20 years in a row. If we then look into the figures, we had, I'm turning to Page 5 now. We had an increase of sales of 13%. But if we adjust that for currency effect, it was a strong 9% growth in Medical solutions business area.



We saw increased volumes, both within the medical device sector as well as in the pharma packaging sector. And we believe that the second half of the year will be in line with last year. Last in Q3 last year, we had some extra sales or extraordinary things of SEK 35,000,000. Dollars So that's why we are having a little bit of that comparison. We see a strong long term growth, and we have the ambition to grow this faster than the market.



But in some single quarters, we could have a little bit less than that. The margin ended up at 12.9%, as I said, sustainable, healthy margins. We have our main project activities within the auto injector, the insulin products and incontinence products. The production capacity that we have increased is completely according to plan. Now turning to Page 6.



You see the 2 different parts of the business area, the medical device, which is the larger portion, and that is working mainly done with things that are helping you to have a healthy situation with active devices. And then we have the pharma packaging side, which is mostly containers for drugs or solid or liquid drugs. Turning into Integrated Solutions on Page 7. We had sales in this quarter of 821,000,000 and EBITDA of 107,000,000, giving a margin, a strong margin of 13%. In this quarter, we had a very high comparison number in Q2 2018.



We had a decrease in sales of, if you adjust for currency, 35%. We see that the inventory situation have been normalized, which means that the high production we used to have in 2018 building stops is now on a normalized level. We have received orders for the new VHP models and retain a very strong position with the customer we have. We had, during the quarter, weak points for the mobile phones, but excellent growth within the E and C business. The margin, as I said, was 13%.



We have higher volumes sequentially, a positive product mix and a good currency effect in the strong market. Now I'm turning to Page 9, showing the 2 business segments of the integrated solution. So we have the consumer electronics, consisting of mobile phones, wearables, connected Wi Fi system and other things like that. And then we have the EMC and thermal working with the shielding solution, thermal management within electronic parts of business,



all kinds of different things.



Now I'm turning to Page 10, focusing on the Industrial Solutions business area. We had a Q2 with a sales of SEK 541,000,000, giving an EBITA of SEK 46,000,000, and that is corresponding then to an EBITA margin of 8.5%. Turning to Page 11. So this €541 gives a decrease of sales by 3% if we adjust for currency and group structure. We had, during this quarter, an inventory adjustments within the hygienic area affecting volumes.



The margin of 8.5% was a little bit lower than previously. We have lower volumes than we have. Impacted the unsatisfactory efficiency in one of the production facilities. We see measures implemented are gradually having an effect, and we see a sequential increase of margin. Turning to Page 12, showing the two parts of the business area, Industrial Solutions.



So we have general industry working with general industrial companies as well as the automotive sector, focusing mainly on the Scandinavian automotive market, such as cars or heavy trucks and other things.



On Page 13, we summarize consolidated group numbers. Net sales of almost SEK2 1,000,000,000 compared to SEK2.3 billion. It's a decrease of 17%, mainly from integrated solutions. Operating profit EBITDA going down from 2.66% to 2.33%, which is mainly a volume effect. The EBITDA margin is 11.7% compared to 11.6 percent, which we consider a strong margin with the lower sales.



Effective tax. The tax rate at the same level as last year, if you compare on the accumulated 6 months numbers, 20.1%. Cash flow after investments, SEK 178,000,000 in this quarter compared to a very high SEK 352 1,000,000 last year. It is a more normal level this year, and last year was very high because of extraordinary working capital effects in Q2 last year. Earnings per share is SEK6.82 compared to SEK7.75 last year.



Net investments impacting cash flow, NOK192,000,000 accumulated after 6 months. It is a lower number than last year. It's more in line with the expected SEK400 1,000,000 for the full year 2019. We have a strong balance sheet with equity assets ratio of 47% at the end of this quarter and net financial assets of SEK 190,000,000 at the end of June. The lease effect from IFRS 16 is explained in this slide package to the meeting, but the effects are very similar to the ones after Q1.



Okay. Now turning to Page 14, where we talk about the current situation, starting with Medical Solutions, where we see a maintain growth strategy, focus a lot on the innovation side, and we have very strong customer relationships. Within the integrated solutions, we have established a position within the new product areas that we sort of transfer ourselves. We have a continued strong position within the EMC Thermal and working with the flexible production structure. In the industrial sector, we have advanced our market positions.



We have efficiency measures taken and gradually having an effect. We can see some indication of slowdown in the economy, but stable volumes. Now, I think we are open for questions.

Q&A



And the first question comes from the line of Karl Rangestan from RODRIGUEZ. Please go ahead. Your line is now open.



It's Karl Alastair from Rodeo. I have a couple of questions. First of all, what I can see, a pretty strong growth from EMC volumes in the quarter. What was behind that? And what can we expect going forward?



I think the reason behind that is we have advanced our market position, both within the telecom business area but also in the new segments that we are gradually going into.



And can we expect strong growth going forward as well? Or was it just a one off quarter? Or



We have a long term ambition within the EMC to move ourselves from previously only being in the telecom business, but moving ourselves into all kinds of different areas. And of course, the reason behind that is that we are looking for long term growth.



Okay. Perfect. And can you perhaps comment on the seasonal variation of the tobacco eating products? What can we expect in the second half there in terms of normalize? You said that the levels are now normalized.



What is a normalized level? And if you can walk through the variations in or the seasonal effects.



Okay. Normalized volume situation means that we are expecting to have sales corresponded more to the sales of our customer. And I think that is something that we have seen now in Q2 and expect that going forward. So we will not have the big swings that we are not expecting that as we have had before when we are in producing building stocks and decreasing stocks for the customer. So more long term following the market development.



I think that's what we really mean by a normalized situation. Seasonal effect, of course, we don't know everything about this market, but I don't expect any big seasonal effects within this market.



Okay. But as far as I know, your customer will launch 2 new models, where one is a new model, the second one is an updated model in Q4. Shouldn't we expect the inventory buildup due to that? Or how should we look upon that?



I think there, now we have a more, how should I say, our customers have much more knowledge about how the market develops. And of course, when switching to a new model, there will be you will decrease the stock of the old one and increase stock of the new one. And I don't think we will see any big swings in that.



Okay. And then the final one. I mean looking into Industrial Solutions, when do you expect the Industrial Solutions? Or do you expect the former measures to Industrial Solutions? Or do you expect the former measures to take back margins to more normalized levels?



Yes. I can start with the comment about the hygiene sector. We see signs of order intake going up in the Q3. So we expect that gradually coming back to a more normal situation.



And regarding the measures, I think we have put in measures, but there is a time lag to get this to sort of get the effect on the margin side. But we expect to gradually see increased more normalized margins going long term forward.



Thank you. Our next question comes from the line of Niklas Zhen from Carnegie. Please go ahead. Your line is now open.



Yes. Hello. Hi. I have a question about the Integrated Solutions segment and DSP, the outlook for that product group, can you please elaborate a bit more on what this means, the normalized inventory situation and new products ramping up? Can we expect unchanged quarterly sales in the second half compared with the second quarter?



Or you've had the guidance before and you're not saying anything right now. So if you can maybe elaborate a bit on the outlook, please.



Yes. To start with the last part of your question about the guidance. We had guidance because we saw the big swings not sort of being market swings, but being supply chain swings. That's why we felt the need for guiding for a period of time. We entered the BHP sector because we think this is a long term growth market, and we think this is going to be an interesting place to be long term.



But exactly how single quarters will be and that we are not really giving prognosis on that. But given the information that we think that we have normalized the sort of swings in the supply chain, we think that our sales will more follow the customer sales and the market development than anything else. And we believe this to be an interesting market that has long term growth potential.



Okay. Got it. But is Q2 sort of a base level where you can grow from? Or is the first half that type of base level that you can expand, grow your revenues from? Or can we sort of compare with something and get the feel for growth going forward?



I think one comment to that would be that we had some quarters during 2017 'eighteen, which had about SEK 900,000,000 in sales for the integrated solution business area. This quarter, we had only SEK 821 1,000,000 in sales. And compared to those EUR 900,000,000 quarters, which we explained contained SEK 600,000,000 of BHP and SEK 300,000,000 from the old telecom business. Then we are a bit behind the sales numbers at those quarters. And so from that, we can see some potential going forward.



And the spread between those two areas within integrated this quarter was that both areas were a bit less than the SEK 900,000,000 in a number of quarters in the historical years behind us.



Okay. Got it. And a final one regarding the Medical side. The comments regarding second half, can you explain this a bit in more detail? Do you expect unchanged organic sales growth in Q3 and Q4?



Or is that how we should interpret that comment?



I think you should interpret that as a second half of the year more situation than the quarters by quarter.



Okay. And total legwadits. Okay. That's helpful.



Thank you. Yes. And one comment to that as well could be that it was mainly in the Q3 last year where we had a lot of extra sales from equipment and development time. So that is one comment as well.



AG. You asked 2 really good questions here, but just to follow-up on one final thing. The Industrial Solutions segment, obviously, you're mentioning a bit of a slowdown in the economy, And you're feeling that you're seeing some signs of that. And then you had negative growth this quarter, mainly partly due to these hygiene clients. I was just thinking sort of when the hygiene client is out of the picture, what would be sort of a good normal underlying growth for the segment going forward?



Would it be negative? Or would you say that it's slightly positive?



To start with, I can say that if the hedging volumes would have been at a normal level, we would have seen a very small growth in this quarter actually. Going forward, it is, of course, in an economical situation where this business area is in business depending on the economical cycle and what will happen there. We haven't seen any dramatic changes lately. And we have, of course, also heard from the other companies reporting and the industrial companies reporting. And of course, we are in that business, some showing positive signs, but some is also showing negative signs.



Yes. Understood. And just one last thing. On the mobile phones, weak volumes, what does that entail? Is that like flat?



Or is that negative volume to growth? Or



It depends, of course, by where you take your stopping points, but I would say negative.



Thank you. Our next question comes from the line of Darren Joshi from Stockview. Please go ahead. Your line is now open.



I have three questions, please. My first question is currently you are manufacturing VHP devices for 1 customer and that customer is sole sourcing their devices from Nalato. Do you see a risk of the customer moving to a dual sourcing of these devices? And how might Nalato mitigate this risk?



So of new products entering new markets is that the customer and the partner tends to form a strong relationship with all the innovation going on. And that normally is true. And you sort of pick 1 customer and you pick 1 partner, and then you work very closely. Over time, we have seen that changing, of course, when the production and the market is more developed and different players on the market have taken their share of the market, and it's more settled. And that normally opens up for the customer to have more than one source and the partner to have more than one customer.



So in a longer period of time, I think this will happen, and it will happen from both sides. Okay. Thank you. Does that answer your question?



Yes. That's clear. Yes. My second question is within the non VHP portion of the Integrated Solutions business, you've highlighted excellent growth in the EMC area competing with weak volumes in mobile phones. Are revenues in the non VHD business net flat on previous quarters?



Or is there a net expansion or contraction in that portion?



You mean the old telecom business?



Yes. So the sort of yes. So if you're splitting it into VHP and Telecom, then that Telecom business, is that flat on previous quarters? Or is that growing or contracting?



It is flat compared to the recent quarters. But then, of course, having in mind that EMC is increasing and we have a less good situation with the mobile phones. But as a total, it is similar to recent



Okay. And my final question is, you've talked in the past about operating a decentralized operating structure. Would you be able to talk about the benefits you see as a result of this and also how unique this model is in the industries in which you operate?



Okay. It's a model that we strongly believe in, and it's the setup that we have been working for many years. And it's the benefit that we see is you are very, how should I say, close to the customer, can make the right decisions where it's needed and not at the central headquarter. So I think the flexibility, the movement together with the customers, making sure you take the right local decisions are the sort of benefits from this model. The downside, I would say, of course, you could lose some economy of scale in this, but from our point of view, this is the best model for outside the business.



In the industry, I think we are on the, how should I say, more decentralized way compared to our



peers. So would you say that many of your peers operate the decentralized structure to a certain extent? Or would you say more the norm is a much more centralized type of operation?



I would say it's more centralized type of model amongst our peers.



And as there are no further questions registered at the moment, I will hand the word back to the speakers for any closing comments, please.



Thank you very much for attending our presentation and for all the good questions. And I hope you all get a very nice summer and maybe some vacation. Thank you.



This now concludes our conference call. Thank you all for attending. You may now disconnect your lines.