16-Aug-2022

Storskogen Group AB (STOR.SE)

Q2 2022 Earnings Call

CORPORATE PARTICIPANTS

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

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

Fredrik Bergegård
Executive Vice President & Head-Industry, Storskogen Group AB

OTHER PARTICIPANTS

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions

Dan Johansson
Analyst, Skandinaviska Enskilda Banken AB

Robert Redin
Analyst, Carnegie Investment Bank AB

Herman Eriksson
Analyst, Danske Bank A/S (Sweden)

Karl-Johan Bonnevier
Analyst, DNB Bank ASA (United Kingdom)

MANAGEMENT DISCUSSION SECTION

Daniel Samuel Kaplan

Co-Founder & Chief Executive Officer, Storskogen Group AB

Hi and welcome to Storskogen and the Presentation of our Second Quarter. My name is Daniel Kaplan and I'm the CEO and Co-Founder. And together with me today, I have Lena Glader, CFO.

So, first, a brief introduction to Storskogen. We are an infinite compounder. We buy small and medium-sized companies. We have an infinite ownership agenda. We are really long-term in the way we view things. We have approximately SEK 36 billion in turnover rolling 12 months and SEK 3.7 billion in EBITA.

And the people doing all the work, more than 12,000 people distributed across 28 countries. We have four market areas and nine investment teams globally working to support our companies and to acquiring new.

So, we have three business areas: Services, Trade and Industry. Services headed by Peter Ahlgren, seven verticals and 61 business units and almost 5,000 – more than 5,000 employees, actually, and about a third of our entire turnover. We have Trade headed up by Christer Hansson, 34 business units and 2,000 employees, 28% of our sales in the last 12 months. And finally, we have Industry with Fredrik Bergegård, 37 business units and almost 5,000 employees.

Giving you an overview on our financial targets, we have an organic EBITA growth target of a real GDP growth of 1% to 2%. This is, of course, in the medium-term. And we had a very strong last year with 36% EBITA growth. This year, we have minus 3%, which is a decent result given the complex macro environment and reflecting the strong comparison numbers of last year.

If we're looking at our growth, including acquisitions, these are to be align with historical levels. This is 60% to 70% over a business cycle with the assumption that we have access to capital. Currently, we are at 121% EBITA growth year-to-date. This is, of course, quite extraordinary. If we're looking at our EBITA margin target of 10%, we're currently at 9.3%. And this is, of course, a challenge, challenging times, reflecting the challenging times that we've had and of course, it's a target for us to reach. It's going to be a challenge for us this year but we are, of course, working towards it.

Then, of course, we have the cash conversion target of 70% approximately. This year, we've had a voluntary and intentional inventory build-up to manage the supply chain disruptions, so we're currently at 32%. However, it is also one of our key targets moving forward to get this back. As we see supply chain disruptions diminish, we have the opportunity to decrease stock levels as well.

And finally, our leverage target, it's interest-bearing debt through EBITDA, and it's 2x to 3x. We're currently at 2.5x which is a very comfortable level for us. It's exactly where we want to be. Of course, we will always monitor this one and adjust it and calibrate it towards the business cycle as well.

Looking at the second quarter, we had a SEK 9 billion in turnover, 16% organic sales growth year-to-date, SEK 877 million organic in EBITA, 129% growth compared to last year. Like mentioned before, the organic EBITA growth year-to-date has been minus 3%, reflecting the complex environment. It's decent but, of course, we are, of course, always working to improve that. And finally, our EBITA margin at 9.7% compared to 10% last year, this is the number which we are quite happy with as the second quarter is seasonably stronger, of course, on the first quarter, but it is the result of hard work from our companies this quarter.

We've done 20 acquisitions, half of those have been add-on acquisitions showcasing our ability to support our companies in their strategic work to improve over time. And finally, a few strategic initiatives which we'll go through a little bit later on our Case Assessment Tool and the knowledge-sharing platform that we launched in the second quarter.

Looking a little bit at the market development. Well, we've seen a fundamentally strong demand in all business areas in the second quarter. Like mentioned before and like you all know, it's been still effects from COVID, supply chain disruptions and accelerating inflation. So, it's been a complex environment. But as we've seen the quarter progress, we've actually seen an increased price stabilization, diminishing supply chain disruptions.

So, these disturbances are gradually being phased out, enabling us to focus more and more on long-term issues rather than managing the short-term volatility. And therefore, we actually have a reasonable outlook in a turbulent market in the next half-year going forward. Then, of course, we have a forecasted recession in 2023 and we are preparing for that potential market development in lots of different ways, everything from keeping our receivables in check and inventory levels and our leverage to give us a good – being prepared for future market developments.

So, if we're looking at the transaction market in the second quarter, it was a very active quarter. We see that the deal flow is declining due to the volatility and results but also before the recession that might be coming. That said, we have nine investment teams. We have a tremendous deal flow that has actually for – on the specifically for us, it has been growing quite a lot. And this gives us the opportunity to be really, really selective and to allocate capital between industries and markets in the best possible way, a part of the Storskogen model. We've also seen declining acquisition multiples both in the second quarter, actually significantly lower than historically at least the last year but also going forward, reflecting the higher cost of capital, of course, that we see in the market.

If we're looking at our three business areas, we have Services. We normally have a weaker first quarter, a stronger second quarter for Services. And we've seen that as well, solid organic revenue growth but suffering from shortages of supplies. It's difficult to recruit people. We have, in fact, a somewhat slower business cycle, might benefit some of our Services companies who have difficulties finding the right people, so it's actually benefiting for them.

Digital Services, Logistics have been doing really well in the quarter, whereas Installation and Infrastructure have suffered more from cost inflation and supply chain issues. We did six acquisitions, half of them add-ons. And if we're looking forward, I think we can see that the high inflation environment, potentially salary inflations or wage inflation over time, might dampen our profitability in the long term.

We did an exciting acquisition and an example of the acquisitions we've made, Swedwise. It's a reseller of various information management systems. It's providing general consulting in all kinds of information, process automation for larger corporations and public sector. It's not a big company, it's SEK 76 million in turnover. But as you can see, quite an extraordinary EBITA margin. And the way we think when we do an acquisition like Swedwise that is what see a very strong team. We see high margins, of course, but also a business cycle resilience. We have a customer base that – lots of government customers, for example, that will have a significant need, the demand for these services over time. So, it's a very good contribution to our Services portfolio.

If we're looking at Trade, we had a continued strong sales growth, but we did have a significant negative impact from component shortages and delayed deliverables, for example, from Asia. And we've done a strategic step-up of our inventory levels to manage sales and through the season that comes along. And this has, of course, taken an impact on our cash conversion as well in the short term. We did 10 acquisitions, 5 add-ons, about half, of course, in this case. And we can see now that material costs, supply chains disruptions, they're decreasing, but they're still at a high level. But it makes life easier for us and easier to plan, of course, when it comes to price increases and purchasing when you have a more stable environment from a price perspective.

If we're looking at one of the most exciting acquisitions this quarter, Scandinavian Cosmetics Group, it's a leading Scandinavian brand management company. It's high-end skin care and cosmetics. It's more than 80 brands. It has a super-automated modern warehouse and more than SEK 1 billion in turnover as you can see, with a decent margin. So what were our thoughts before this acquisition? Well, as you know, we have our Health and Beauty vertical. It's a fast-growing vertical for us, actually more than SEK 2 billion in turnover at the moment. We are market-leading now in the Nordics and this is complementing our great companies in hair care, for example. And this is a company with good margins and stable margins over time. So, that's Trade.

Moving on to Industry where we will talk to Fredrik Bergegård very soon, we had a solid demand throughout Q2. Of course, we had a very strong development year-to-date. And even last year was quite extraordinarily strong, so they're doing a really good job at this point. Good development in volumes, in efficiency improvements, price increases that are finally coming through to our end customers. We can see that the onshoring trend kind of benefits a lot of our companies, for example, within Automation, helping our customers being more efficient and lean in their production in, for example, Northern Europe.

We did two new business unit acquisitions and two add-ons. And we can see that some of the material prices are moving downward, and we have a strong order books, et cetera. We still have a low visibility especially for 2023, so it's difficult to guide you on that one going forward. So if we're looking at one of the most exciting acquisitions that we did in the Industry at the last quarter, we have J & D Pierce based in Scotland, almost SEK 1.7 billion in turnover, with about a 10% EBITA margin.

This is an industrial company doing steelworks, steel construction. They're superefficient, they're highly automated plant and then, of course, they set up these XXL sheds. They're also building – actually, they're rebuilding or helping to improve the Anfield Stadium now for Liverpool, so that's an exciting project as well. And they have a strong track record of top line growth. They have a very strong pipeline going forward and some of the best customers around. So, it's a quality company and we look forward to help to nourish it in the years to come.

And all in all, if we're looking at our portfolio, it's very diverse. And of course, it's a key component of our strategy to be in lots of different industries and different geographical markets, getting that resilience for a potential recession, for example. So anything that happens in the markets will affect us, but not at the same time and to the same extent in our different verticals. So, no single vertical more than 14%. Just to understand these companies, most of them have been around for quite some time. Our biggest 20 companies, they've been around for, on average, 47 years, have been both ups and downs. So, we feel very confident that our business model really is supported and will kind of show its value in the times ahead.

Significant events after the reporting period. We've done a few acquisitions adding SEK 38 million in EBITA and we have an LOI and preferred buyer pipeline of about SEK 200 million. This is for those [indiscernible] (00:14:18) somewhat less than we normally have. And as you know, from a seasonality perspective we don't do many acquisitions in the third quarter. That said, we are also, like I think we mentioned both in the presentation of the fourth quarter and the first quarter, seeing a somewhat slower acquisition pace going forward. We have deployed now most of the proceeds from the IPO in a good manner, so the money has been put to work and we're now into more a normalized acquisition pace going forward.

So, financial performance, Lena?

Lena Paulina Glader

Chief Financial Officer, Storskogen Group AB

Thank you, Daniel. So, let's have a closer look at the quarterly numbers here. We had, of course, a strong sales growth in the quarter and we had a solid margin and profitability. So, let's talk a bit about that. Sales growth was 137% year-on-year in Q2 to just above SEK 9 billion. And this is driven by organic growth, obviously, in the first half of the year, throughout the first half of the year, as well as by – and the organic growth is again driven by both volume and price and, of course, largely also the sales growth is driven by acquisitions.

The LTM, that's the owned 12-month period sales, amounts to SEK 26.8 billion. And the RTM, that's the pro forma as if we'd owned all the subsidiaries for the entire last 12-month period, that sales is amounts to SEK 35.7 billion. And then a quick comment on EBITA, also grew by 129% in the quarter year-on-year to SEK 877 million in the second quarter. Again, the LTM, that's the owned 12-month period, amounts to SEK 2.5 billion in terms of EBITA. And the pro forma RTM number is SEK 3.6 billion that Daniel showed here, I believe, on the first page.

The margin was 9.7% in the quarter which is, of course, a significant improvement from Q1 when we reported a margin of 8.2%. Now, the second quarter is seasonally stronger. The margin was, however, helped by, of course, successful implementation of these price increases that we discussed then at the previous quarterly Q&A and session. These price increases have come through in Q1 but also in Q2. And we've made further price increases successfully in Q2 as well which has, of course, helped the margin. And an overall strong markets, good demand and operational performance has also been driving the margin improvement sequentially. We are just a little bit short of the 10% target and the 10% that was reported in Q2 last year.

However satisfactory, the margin would, of course, have been higher had we not had these supply chain problems that Daniel mentioned as well that have resulted in project delays in Services and – especially in Services but also in other business areas. And we've also, of course, continued to see high input prices, higher cost of goods sold and due to inflation, et cetera, and all of this has, of course, impacted margins slightly negatively. So, the margin would have been higher had we not had these, of course, disruptions out there.

EPS grew by 79% in the quarter or quarter by – year-on-year, I'm sorry, to SEK 0.25 per share in Q2. And the first half of the year, EPS grew by 36%. And of course, between the EBITA and the EPS or the net profit that you don't see here on this page is the taxes paid which have been stable percentage-wise compared to Q1. And then, we have net financial items where we had a positive currency contribution in the second quarter, whereas we had a negative contribution from FX. And a lot of this is, of course, unrealized as well in Q1. So, 36%, nevertheless, improve or increase in EPS year-on-year in the first half of the year.

Return on equity of 9.2% and return on capital employed of 9.6%, which is stronger than last year. Both of these metrics are diluted by growth as well as, of course, by undeployed capital raises that we have done quite large amounts of in the past 12-month period. It's important to continue to monitor these return metrics. I understand that some peers have decided to – have chosen to report return on capital employed net of cash, whereas we actually report it on a gross debt level. So – but calculating this on a net debt level instead, the return on capital employed would be equivalent to 11.9% which is, obviously, stronger.

Here on this page, we show quarter-by-quarter sales and EBITA margin developments. What can we say about this? Well, we've had a strong sales growth, obviously, driven by acquisitions and by organic growth. And the margin of 9.7% is an improvement from Q1 and Q4. The margin of Storskogen in this past period, three years at least, have been moving at around plus/minus 1.5 percentage points around the target level of 10%, which is the medium-term target of – in terms of EBITA margin.

The illustrative EBITA pro forma bridge shown here is calculated always on a 12-month rolling basis. So, starting with the owned period, that's the profits during our owned period in the last 12 months amounts to SEK 2.479 billion. We've made acquisitions obviously during this period. That adds another SEK 1.165 billion, so the pro forma EBITA of SEK 3.6 billion on a run rate at the end of the quarter.

We've added four, we've signed four smaller acquisition since. That add a total of SEK 38 million in terms of EBITA. And so, the run rate today, including this, would be SEK 3.68 billion. And then, there is the pipeline that Daniel mentioned before of letter of intent and preferred buyer status cases. That would add another SEK 200 million if we close them. So, that would bring us to closer to SEK 3.9 billion in terms of run rate EBITA.

A quick look at the business areas here starting with Services. That had a strong sales growth obviously driven by acquisitions and also by a really good organic sales growth in the first half of the year of 16%, which brings altogether acquisitions and organic growth brings sales to SEK 3 billion in Q2, which is a year-on-year growth of 85%.

And we have a sequentially improved margin in Services to 8.7% margin. Many verticals have struggled with supply chain that we've talked about before with delayed projects and also high cost of input goods and cost of goods sold. So, that means that the margin is still below potential despite really strong contribution from Logistics and Digital Services verticals, in particular.

And to the right here you see the LTM margin trend. That is now approximately 1-percentage-point below the previous historic levels of around 10%. And as I said, we're running a bit below potential here due to these external factors mainly.

And then moving on to Trade, which also had a strong sales growth of 100% actually in Q2 to SEK 2.5 billion. This consists of organic, very strong organic growth again of 15% in the first half year as well as acquisitions obviously. EBITA margin was 11.9% in the second quarter, which is 2 percentage points actually higher than in Q1, thanks to successfully implemented price increases largely as well as by generally strong demand out there in the market and by really well-run businesses overall, I should say.

Organic EBITA growth of a minus 9% year-to-date is hampered by specifically two subsidiaries that have had fixed pricing and that they have not been able to change despite significantly higher costs in the projects. And excluding these two specific subsidiaries, the organic growth in the first half year would actually be plus 2% instead of the minus 9%. The LTM margin, again, on a rolling 12-month basis, as you can see here to the right, is fairly stable, close to the 11% historic level of the business area.

And then finally, business area, Industry, also a strong sales growth, 20% organic in the first half year driven by volume and prices and quite significant acquisitions made in the business area, Industry, which means that the year-on-year sales growth is 276% to SEK 3.5 billion, which means that Industry is now our largest business area.

We've also seen a margin uptick here in Industry as we've seen in Trade and Services in the second quarter compared to the first quarter now at 11.6% in Q2 driven by, well, this organic EBITA growth of 19% in the first half year. And that is helped again by implemented price increases and generally strong markets. LTM margin to the right here is 11.3% also, close to the or slightly above around the 11% level where it has moved.

Finally, a couple of words on the cash flow. Cash conversion, which is one of my favorite metrics as you know. In the second quarter as in the first quarter, inventory levels continue to be above normal levels. We also continue to see inflated prices in the inventories, which all of this has led to high, to negative working capital contribution from inventories. Regarding the receivables, where we had quite significant negative contribution in the first quarter, this is now much less in the second quarter, back at normal levels again. Taxes paid also back at normal levels in Q2 where we had quite high paid taxes in the first quarter.

So, regarding the cash conversion, it was 44% in the second quarter and on the LTM, that's a rolling 12-month period, the cash conversion rate was at 32%, which is obviously below the target of 70%. And efforts are being put into managing this, especially inventories, but also receivables of course to make sure that we are getting back to the target level of around or above 70%. CapEx to sales at 1.1% in the quarter.

And moving onward from cash to the liquidity bridge, how we have used the cash during the quarter. We entered the quarter with SEK 2.9 billion at the bank. We've added SEK 355 million in positive operating cash flow during the quarter. We have made 20 acquisitions during Q2. And alongside other investments, the total amount of investment is SEK 3.7 billion in Q2. We have funded this through own cash flow, of course, but also through financing, new financing amounting to SEK 4.155 billion during Q2. Tiny, tiny FX effect there. This all adds up to a cash balance of SEK 3.758 billion at the end of the quarter. In addition to this, we have unutilized credit facilities of SEK 7.559 billion. So, that means that the total available liquidity is SEK 11.3 billion at the end of Q2.

And then, how does this translate into leverage and indebtedness? Well, we had interest-bearing net debt of SEK 12.1 billion at the end of the quarter and an interest-bearing leverage, that Daniel mentioned before, of 2.5 times which is within the target range of between 2 times and 3 times.

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

Thank you, Lena, for now. Let's focus now on business area, Industry, and Fredrik Bergegård. Welcome, Fredrik.

Fredrik Bergegård
Executive Vice President & Head-Industry, Storskogen Group AB

Thanks, Daniel, great to be here.

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

So, last time we had a deep dive into business area, Trade. Now, it's time for Industry. You've had a fantastic journey just a few years ago where you were about 25% of total. Now, you're about 40% of our total sales in Storskogen. Great acquisitions and great work organically as well. Tell me, how has the year been for Industry so far?

Fredrik Bergegård
Executive Vice President & Head-Industry, Storskogen Group AB

So, of course, we're very happy with the performance so far. And I must say, I'm extremely proud of our CEOs and our teams and the way they have managed their businesses.

Looking at our organic growth, so far this year we have had a 20% organic growth both in sales and in EBITA. And that is on top of the 53% we ended up full year last year, 2021. And then, of course, with some acquisitions of really nice companies on top of that, our sales in the last 12 months has grown from SEK 5 billion last year, full year. Now, after first half this year we're at SEK 10 billion, so we're happy.

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

So, that's quite an extraordinary growth. So, what are the main drivers do you think behind this success?

Fredrik Bergegård
Executive Vice President & Head-Industry, Storskogen Group AB

Of course, you can say a lot about this. But I will say, I mean considering the difficulties with the war starting and, I mean, for Q1 the COVID had a severe impact on all businesses I would say. I mean, there has been a surprisingly strong demand. But then with nice companies like we have, I think we almost like benefited from this situation where it's been tough with shortages, transportation problems, disruptions in the supply chain, costs and so.

But once you have the nice companies with people who are ready to go that extra mile, I think we have really even leveraged upon that strong demand. And in many cases, we actually have several companies with all-time high order books as we speak. So very, very good. So I would say, strong operational excellence and then, of course, on top of that, some really nice acquisitions.

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

Wow. So, I mean you mentioned some of the challenges. How does that affect the business area, Industry?

Fredrik Bergegård

Executive Vice President & Head-Industry, Storskogen Group AB

Yeah. So, I mean coming from 2021, of course, there was a lot of difficulties. But then there has been really strong underlying demand all the time. And then we have been able to work with prices and we have managed prices very well, covering up for the cost increases we have had and increased, of course, our prices. And then we have also worked with availability. I mean, we have made sure that we had things to sell in stock and serviced our customers.

So, we come from that situation. And now, we're prepared for moving focus to more cost control, even more like cost focus and especially maybe working capital focus. And then, we'll now, of course, maintain our well-managed prices and cost control. So altogether, that I think we're very well positioned. And it's difficult to say what's going to happen. No one can say what's going to happen. But I think, with the companies we have and with the preparations we have done, I think we're as resilient one can be in this climate.

Daniel Samuel Kaplan

Co-Founder & Chief Executive Officer, Storskogen Group AB

All right. Very interesting. So, I mean we have a tight schedule, so we won't fit everything into here. We will have two more video clips. You can find at the moment on our website. One of them is a deep dive into business area, Industry. And so, what will we talk about in that video clip?

Fredrik Bergegård

Executive Vice President & Head-Industry, Storskogen Group AB

Yeah. So, yeah, that's going to be really good to do that with you as well, Daniel. So then we're going to take the opportunity to look into business area, Industry, how we have focused on the three verticals, Automation, Industrial Technology, and Products; and how we build knowledge and know-how within these verticals, at the same time being diversified and how we manage that in the portfolio.

And then, we're also going to look at some – what we see as the strong underlying trends and our focus and say a little bit about how we support our companies with our central organization. So, you will get to know business area, Industry, a bit better.

Daniel Samuel Kaplan

Co-Founder & Chief Executive Officer, Storskogen Group AB

Thank you. That's very interesting. And one other clip. It's with one of our oldest companies and how we work with that. Can you tell us something more about that?

Fredrik Bergegård

Executive Vice President & Head-Industry, Storskogen Group AB

Yeah. So, the second clip, we have a case study, you can say, of ÅMV, as you say, one of our oldest companies in Storskogen. And ÅMV's CEO, Robert Ohlsson, will join us. So, we will film that together and you will hear also Robert's view on the business and how it's like to work in the Storskogen family.

But then, we will see some examples on how we have worked with succession, actually a turnaround case of ÅMV, as well as investments in an add-on acquisition to ÅMV, and some investments in the machine part. So how we, in a hands-on way, also work and support our companies; and ÅMV is one example of that.

Daniel Samuel Kaplan

Co-Founder & Chief Executive Officer, Storskogen Group AB

Thank you, Fredrik, for some deeper insights into business area, Industry. For those of you interested, we have the two clips available on our website in our video archive. So moving on in the agenda, we will now look at some of our strategic initiatives, our key takeaways, and Q&A.

So, looking at two of our strategic initiatives from the quarter, CAT and KX. The first one is the Case Assessment Tool and Prioritization Tool that we utilize across the organization. It's all about capturing 10 years of acquisitions and the knowledge and to continue to do acquisitions consistently scalably when we're evaluating pricing and prioritizing between various acquisitions.

Of course our main target is to increase the risk-adjusted earnings per share growth. And, of course, when we prioritize among cases, we have lots of subsidiary targets as well. That kind of builds up to that EPS growth. Sustainability, of course, drives long-term growth. We believe diversification reduces risk. Strategy realization, we have, of course, strategic thoughts both on a overall level, vertical level, and business unit level. And operational predictability, so that we can manage our organization. And finally, a delegated business model, so that our business unit managers, our investment managers, our investment directors, and various country managers can make decisions independently. And we're using the same frameworks as we do across the organization.

And all of this has to be tempered by the fact that we have a macro environment, in this case, market uncertainties, potential recession. So, our core focus at the moment, for example, is operational excellence, diversification. So, we're carefully allocating capital according to our strategic principles that we have set across.

Then, of course, we're evaluating each on an individual case, in this case using the Case Assessment Tool. This is not rocket science. We've basically used it for many years, but we have now summarized it in a joint tool that is available for everybody in the organization. It's macro and market analysis. It's commercial and operational analysis, financial profile, of course. We're primarily looking at forward-looking earnings capabilities of these companies. We're not so much concerned about history. And, of course, you have ESG and sustainability, key aspects of our evaluation process.

And finally, price and process. Are we competitive? Is it worthwhile spending time on this one? And then we rate all of these aspects of the business. But it's not a mathematical formula. It's all only a basis for discussion in the end. It's a complex decision, utilizing many different inputs. But this of course will enable us to scalable, to consistently evaluate, to avoid unnecessarily mistakes, and to, in the end, improve capital allocation, improve acquisition decisions, and be an even better company moving forward.

Another tool, which we launched in our big CEO Days, just before summer, we called it previously Business Excellence Groups; nowadays, Storskogen Knowledge Exchange. We currently have six major areas where we've done these initiatives. And it's also about capturing the knowledge in the organization. 12,000 specialists and industries and domain competence. And this target pricing, HR, procurement, digital channels, finance, and ESG to start with. And all of these knowledges and all of these projects are captured as well on our joint knowledge transfer platform, Knowledge Exchange platform as well.

And we can see already significant benefits from this joint pricing projects, on how to price and how to communicate with customers on pricing, driving new revenue streams and increased margins. HR, how do you retain and attract good people. Joint procurement projects, benchmarking, procurement prices as well. Digital channels, how do we improve conversion and click rates and sales of course across our many different business areas. And we have a deep expertise not only from the companies we've bought in this area, but also capturing that from our marketing managers from our different organizations.

Finance, monthly video tutorials. We have a macro analysis, a macro tendency report basically seeing how our companies develop. And the ESG with quarterly primarily and sometimes monthly follow-ups and educations of our companies across various aspects of the ESG arena. All in all, capturing the knowledge, providing synergies. In the end, really creating operational excellence and increased margins and profitability over time. So, that's two of the strategic initiatives that will drive long-term performance for Storskogen.

If we look at some key takeaways before we move on to Q&A. All in all, it's been a solid quarter. It's been a strong demand. It's been a very complex market environment. It's easy to forget that. But I think our business units and our management teams have done an excellent job pushing on price increases, managing supply chain issues. We've done a number of strategic acquisitions, about 50% add-on acquisitions, supporting our companies in their strategic agendas. And, all in all, it's resulted, as I said, in a solid quarter with a decent margin.

And as you can see on the picture, that's actually a bridge which we built on [indiscernible] (00:42:09) for those of you who walk there sometimes. I think one of the awards for construction in Stockholm or something like that. So, it's quite an extraordinary thing.

Well, thank you for listening this far. Now, it's time for Q&A. Operator, please take over.

QUESTION AND ANSWER SECTION

Operator: Our first question comes from Carl Ragnerstam at Nordea. Your line is now open.

Carl Ragnerstam Q
Analyst, Nordea Markets, Corporates & Institutions

Hi. It's Carl here from Nordea. A few questions from my side. Firstly, I just wonder if you have seen any changes in the demand...

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

I can't hear anything.

Carl Ragnerstam Q
Analyst, Nordea Markets, Corporates & Institutions

...throughout the quarter. Can you hear me again here?

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

No. Very, very weak. You have to raise the volume.

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions

Q

Can you hear me? Okay. Is it better?

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

A

Higher.

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions

Q

Yeah. I'm not sure if the system is working. Can you hear me?

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

A

Yeah, I can hear you weakly. I will try to hear you.

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions

Q

Okay, let's try. So, have you seen any changes in the demand situation throughout the quarter and also in July and August as well? And also, if you could shed some light on the order intake growth. I know you don't publish that number, but if you could shed some light on it.

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

A

Very good question. I mean, it's been a very strong demand the entire first half year. We didn't really see any decline in demand even during summer. There is of course some anticipation for potential recession for next year, but we can't really see any actual consequences of that just yet.

When it comes to order intake, I mean, that's mostly relevant for Industry. And they actually have record high order books, so they're looking extremely strong actually. So, so far good demand I have to say.

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions

Q

Okay. That's very good. And also, I mean, your organic EBITA growth, I think it looks down by 10 percentage in the quarter. You partly mentioned the two companies in Trade, which significantly underperformed during the fixed prices. So, what measures have you been implementing to solve this? And should we expect operational improvements from these already in Q3 or is it too early to be seen?

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

A

I mean, most of the things, they could be a little bit more of temporary nature. I think when it comes to one of the companies in question, they have long-term customer contracts with end consumers basically, and that takes a while before that is lessened. On the other hand, we actually see declining or stabilizing material prices. So, that could actually remedy the situation for those companies in question.

All in all, I think those are a little bit more of temporary nature, I would say. Not to say that they're immediately fixed in the next quarter, but not really in the long term, an issue in the long term. Yeah.

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions
Q

Okay. Very good. And also, I mean, looking at the operating cash flow, it's also a bit soft due to working capital buildup. Could you just sort of help us bridge the inventory either sequentially or year-over-year and, for instance, try to split out the pricing effect it had on inventory, and also whether we should expect the working capital release when entering the second half, I guess owing to easening supply chain?

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

I think from a general perspective, you're spot-on. I think we are expecting – we can see diminishing problems in the value chain overall. More and more shipments coming in on time. China is, of course, still – it's still a mess from a delivery perspective. But, all in all, stabilizing prices, even declining prices, more and more stable supply chain issues. So, the requirement for us to continue to increase inventories is reduced.

So, it's basically on the contrary. I think we will have it as a top priority in the year to come to get that cash conversion up to Speed. Both of course, – I think the issues on receivables are more or less reduced or solved. But I think when it comes to inventory levels, those are coming down over time.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB
A

I might add that regarding the receivables in Q1, there was no really issue. It was as exactly as we said then. It was a result of prices and high volumes at the very end of the quarter that resulted in this. But those were then, as expected, paid in April and May. So, I wouldn't be too worried about that. But, again, if we're seeing a softer economy, then of course this is and should always be a priority for any CFO, I believe, and company.

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions
Q

Very good. And the final one from my side, I personally think that you brought up a great point in the report, which is potential divestitures. Could you perhaps shed some light on how many of your company is on perhaps LTM basis that are on breakeven or perhaps loss-making? And maybe it's in the report, but have you made any divestitures so far?

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

I can't really answer your first question exactly how many are unprofitable at the moment. There are a few. We haven't done any divestitures so far. We will make them eventually. I think we're continuously evaluating and reevaluating our holdings. Are we the right owner? Do we believe in this company in the long term with us as an owner? So, there will be some divestitures, even though potentially not in the very near future at least.

But on the margin, we will kind of manage the portfolio as such. But I think if we find that we have a company which we really believe in, it's going to be a good deal in the long term, but they are temporarily underperforming. That is not a good cause for us to sell it. But we do have a few companies that might be up for sale eventually.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB
A

No divestiture in the quarter.

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions
Q

Okay. Very good. Thank you.

Operator: Our next question comes from Dan Johansson at SEB. Your line is now open.

Dan Johansson
Analyst, Skandinaviska Enskilda Banken AB
Q

Thank you so much. Good morning, Daniel and Lena. I hope you can hear me okay.

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

Yes.

Dan Johansson
Analyst, Skandinaviska Enskilda Banken AB
Q

Great. Three questions for me [indiscernible] (00:49:55). Perhaps a follow-up on organic growth. Is it possible to share how it developed month-by-month during the quarter? Was April, for example, much stronger than June, or do you see a quite even development here throughout the quarter?

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB
A

Yeah. I'm sorry. We were waiting for another question. But of course, we'll take that first. We're not, as I said – I mean, we're not giving any specific organic growth figures for the isolated quarter or for isolated months. So, yeah, that's...

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

We can't really say, from a tendency perspective either that we've seen any significant trends with regard to demand across the demand side there. So from a more principal perspective, we haven't seen any of those indications.

Dan Johansson
Analyst, Skandinaviska Enskilda Banken AB
Q

Okay. Thank you. Perhaps a question on for Lena. In a normal year, would you characterize Q2 as a good cash flow quarter? It looked quite good in Q2 last year, but [indiscernible] (00:51:01) COVID and whatever. Could you remind us in general, which quarters you typically release more cash, and which quarters you typically consume more cash?

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB
A

Well, Q2 last year had kind of a one-off effect in it related to certain large projects and acquisitions. And so, this exceptionally strong cash flow in Q2 last year is definitely not a normal level. And then, in Q3 last year we saw the reverse effect, if you have a closer look at that. So, you should actually view Q2 and Q3 as kind of a one entity rather than two.

So from that perspective, it's not really a good quarter to compare against. We generally have strong sales in Q4. It's a strong quarter where we, in Q3, tend to have inventory buildup to be able to deliver on the Q4 sales. And that would be kind of a normal tendency. Now, however, having said that, going back to what Daniel just said as well about us, now having already above normal inventory levels as do most companies out there as far as I can tell.

And so, now is the time to start to work towards normalized inventory levels. So what that effect from, on the one hand, us, working to get inventories lower in Q3 and, on the other hand, securing that we have enough inventory to sell in Q4. How that effect is going to balance, I can't really give you any guidance on right now.

Dan Johansson
Analyst, Skandinaviska Enskilda Banken AB
Q

Okay. Thank you so much. And perhaps a final one, in terms of M&A, you're currently at 2.5 times net debt to EBITA. Given that we potentially anticipate a bit of slower smaller market as you have discussed throughout this presentation, are you satisfied with the current debt level and should we expect further or future M&A mainly funded by the operational cash flow that we [indiscernible] (00:53:14) perhaps one to three quarters?

And so, rather than you increasing leverage further towards the 3 times upper-end of the target, how do you think about the balance between higher leverage basically versus growth internally right now?

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

I think, I mean we're currently at 2.5x to net debt to EBITDA when it comes to interest-bearing debt, and I think that's a level we're really comfortable with. I think if we were looking at a strong business cycle, we could well go to 2.8x. In a weak business cycle, I think like the ones that we potentially entering now, I would rather see it decline rather than increase.

So I think 2.5x is actually somewhere where we would want it to be. So we're not seeing an increase, to be direct, in the leverage rather on the opposite potentially. So being a little bit conservative on the leverage going forward, I think that's the signal. So, like you said, I think the more normalized level of acquisitions will be primarily be funded by operational cash flow.

Dan Johansson
Analyst, Skandinaviska Enskilda Banken AB
Q

Okay. Perfect. Thank you so much. That was all for me for now. Thank you.

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

Thank you.

Operator: Our next question comes from Robert Redin at Carnegie. Your line is now open.

Robert Redin
Analyst, Carnegie Investment Bank AB

Q

Yeah, hi. So, a question coming back to the sort of like-for-like margins or around organic EBITA development in Services. I guess, it's a sort of [indiscernible] (00:54:49) industry-wide trend that margins is being pressured by cost inflation and other things. But what are you seeing there? And what is the balance between price hikes and the cost development in the coming quarters? Do you foresee margins coming back up again like the like-for-like in Services?

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

A

I think we do see a strong demand. Utilization is very high actually in most of these sectors. Surprisingly enough, we really can't see corresponding price increases, so the margins are pressured. If there will be wage inflation, I think we will probably be able to push that onwards to customers. But we still see somewhat contracted margins and we don't necessarily see that being alleviated in the near term. So I think a continued good demand, but weaker margins in that sector. I think that's – would you agree on that estimate? Yeah?

Robert Redin
Analyst, Carnegie Investment Bank AB

Q

All right. And then, that comment also comments about [indiscernible] (00:56:07) Q4, is that mostly a sales comment or is it a margin comment as well or how do you think about that comment?

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

A

I think when it comes to seasonality on the Service sector, it's basically that people are on vacation in July and in Europe in August. So, basically less people are in place to do the work. I think it's not really a margin issue in the near-term from that perspective. When it comes to Trade, then it's more of a question of when the invoices go out and get paid and stuff like that where we have a quite a good transparency that we will see a strong Q4 and a weaker Q3, but seen as the half-year is going to be quite normal, I think, from that perspective as well. Industry is doing very well. We don't see any weakness in that order book at all, and that includes margins as well. So, then, of course, visibility kind of decreases as the farther away you look, of course, into 2023. So, yeah.

Robert Redin
Analyst, Carnegie Investment Bank AB

Q

All right. Perfect. Yeah, because I saw in some quarters in the past that you had actually a good margin quarter.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

Well, can I just comment on that one quickly? If you look at 2020 then, of course, we had – that was the COVID year so that was not – the Q2 and Q3 seasonality was not really like a normal year, I would say, in 2020. And 2021 was an exceptionally – was not exceptionally but it was a strong year overall. So, the normal seasonality, if you look further back behind like in 2018, 2017, 2019, then you would see that seasonality.

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

A

Yeah.

Robert Redin
Analyst, Carnegie Investment Bank AB
Q

All right. Perfect. Thank you so much.

Operator: [Operator Instructions] Our final question comes from Herman Eriksson at Danske Bank. Your line is now open.

Herman Eriksson
Analyst, Danske Bank A/S (Sweden)
Q

Thank you and good morning. So, just one more question from my side. On your M&A actions, you have built up a quite significant M&A organization. And now, when you're going to have a more normalized M&A growth going forward and probably more by your own backlog, is it reasonable to expect that you will slim your M&A organization or how do you look at it?

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

I think we feel that we are quite well-staffed for the challenges ahead. I think there is, of course, some activity where some of our M&A people are now working operational with the companies. We're doing a lot of add-on acquisitions, so there is a fine line which is what is operations and what is M&A. So, we don't look at – we don't foresee any kind of layoffs or anything like that. We feel quite comfortably staffed going forward at the current level.

Herman Eriksson
Analyst, Danske Bank A/S (Sweden)
Q

Okay. Thank you. That was all.

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

Thank you.

Operator: Thank you. Our next question comes from Karl-Johan Bonnevier at Danske Bank – DNB Markets. Please, go ahead.

Karl-Johan Bonnevier
Analyst, DNB Bank ASA (United Kingdom)
Q

Yeah, no, no. It's big difference between the Danske and Norwegian banks, so. Good morning, Daniel and Lena.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB
A

Good morning.

Karl-Johan Bonnevier
Analyst, DNB Bank ASA (United Kingdom)
Q

So, hey, congratulations to two good developments in Q2. But I need to come back to the free cash flow generation. And early, you indicated to me, Lena, that obviously Q1, Q2 was going to be hampered by what we saw out there, particularly in the Trade flows and similar things seem requiring inventory. But now going into the second half, is there something new that you see there that will not allow for you to have, say, a strong free cash flow generation in the second half of this year?

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

No, not really. As I said to the previous question, I mean, we are working with getting cash conversion back to the target level for sure. Those are quite big efforts being made within – from Storskogen and then, of course, mainly the biggest effort is being done within the subsidiaries, of course, to get that back. And that is mainly has to do with inventories because there is no – of course, you can always improve receivables and days outstanding, et cetera, but it's largely the inventories where we've had these kind of larger fluctuations and build-up. So, hope that we can get that down to really some more cash flow, for sure. But the market has proven to be quite unpredictable the past six, nine months at least due to supply chain disruptions and...

Karl-Johan Bonnevier
Analyst, DNB Bank ASA (United Kingdom)

Q

For sure. It's a fluid environment out there.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

...external factor. Yeah.

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

A

Yeah.

Karl-Johan Bonnevier
Analyst, DNB Bank ASA (United Kingdom)

Q

And also, looking at your net debt of about SEK 12 billion, how should we see on the financing cost of that? The STIBOR rate is now moving up pretty quickly and looking at [ph] the FRA rates (01:01:19) for the – towards the end of the year, we are looking at even higher rates. So, how are you – how is that financed within the yield curve for you?

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

Well, if you look at the funding of the interest cost for that, you can actually calculate that, I guess, yourself pretty well. It's just above 3%, 3.3% or somewhere around that, which is a result of the bonds we have that are 300 basis points above the three-month STIBOR, and then we have a lower interest paid on the RCF, and then a slightly higher interest paid on leasing. So, that's around the mix where we are today. And we have secured – we have mainly floating rates. We have started to actually hedge some of it now. Roughly 10% of the external loans are now tied to a longer interest.

Karl-Johan Bonnevier
Analyst, DNB Bank ASA (United Kingdom)

Q

And, Daniel, when you look at that extra that comes in when you add the – say, the minorities and the delayed payments, so to say, in the transactions you have done, how does the payment structure for that look over, say, the next quarters or maybe years? How much can you stretch that out?

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

If I understand correctly and you can help me out here, Lena, out of the minority options which are more than SEK 2 billion, I think in total, I think it's about SEK 100 million which is due the next 12 months or something.

Lena Paulina Glader A
Chief Financial Officer, Storskogen Group AB

Yeah.

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

So, it's an extremely small portion of that one. Most of these minority options are four to five years off in the future if the companies perform more or less above planned. So, it's less of a concern in the near or even midterm future, actually.

Karl-Johan Bonnevier Q
Analyst, DNB Bank ASA (United Kingdom)

Excellent. Thank you very much and stay well out there.

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

Thank you very much.

Lena Paulina Glader A
Chief Financial Officer, Storskogen Group AB

Thanks. Thank you.

Operator: There are no further questions at this time. I'll hand over to the speakers for any closing remarks.

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

Well, thank you for listening in and for your questions that, hopefully, we've given satisfactory answers. Have a wonderful day, yeah, and thank you from us.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

Thanks.

Fredrik Bergegård
Executive Vice President & Head-Industry, Storskogen Group AB

Thank you. Bye.

Lena Paulina Glader

Chief Financial Officer, Storskogen Group AB

Bye-bye.