

October 27, 2022

Nolato

Q3 2022



Speakers



Adrian Gilani

Equity Research Analyst | ABG



Carl Ragnerstam

Managing Director and Head of Small Cap Research | Nordea



Christer Wahlquist

President and CEO | Nolato



Johan Skoglund

Equity Research Analyst | DNB Markets



Michael Lofgren

Research Analyst | Carnegie



Operator



Per-Ola Holmström

EVP and CFO | Nolato

Prepared Remarks

**Christer Wahlquist**

President and CEO | Nolato

Thank you, and welcome to the presentation of Nolato's third quarter 2022. This is Christer Wahlquist speaking. If we start on page two in the slide deck, we have a quarter with the sales at SEK 2.6 billion. This sales was affected by lower VHP sales, as previously communicated within Integrated Solutions, but increasing sales within Medical and Industrial, of course, fueled by inflation and currency effects. The operating profit, EBITA, amounted to SEK 214 million, and thereby creating a margin on the EBITA level of 8.1%. We saw the lower margin that was affected by inflation and production efficiency measures. The cash flow after investment increased to SEK 166 million, as a result of lower investments during the period.

**Christer Wahlquist**

President and CEO | Nolato

Turning to page three, the Nolato group is working as a solution provider for global leading customers in different segments. The three business areas are creating synergies for our customers and competitive advantages for the Nolato group. If we then start on page four with Medical Solutions, as you see on this graph, we have had consecutive growth, actually over 25 years since the creation of the medical business area. And then, of course, during the period, numerous acquisitions, creating global leading solution provider for the medical and pharma industry. We turn to page five, focusing on the different segment of product areas within Medical Solutions. We have, of course, the IVD, diagnostics, in vitro diagnostics, corresponding to approximately 18% of the sales. Cardiology, 7%. Pharma packaging, around 12%. Continence care, 12%.

**Christer Wahlquist**

President and CEO | Nolato

Endoscopy and General Surgery, amounting to approximately 20% of our net sales. Drug Delivery at 15%. If we then go into the details of Medical Solutions third quarter, we saw a 27% increase in sales. This was approximately half of that came from currency effects. I would say approximately half of the rest came from adjustment of cost inflation. Of course, we saw that IVD volumes were low during the quarter due to the pandemic related inventory adjustments, but we saw good growth in the surgical area. The EBITA margin ended up at 8.4%, and of course, affected by the change in sales mix between the IVD and the surgical area. Also, inflationary effects and higher manufacturing costs, and this was particularly in the United States.

**Christer Wahlquist**

President and CEO | Nolato

Cost impact of the capacity investments made in 2021 that are not fully utilized yet. The quarter ended up at sales of SEK 1.245 billion and an operating profit of SEK 104 million, creating the EBITA margin of 8.4%. If we then turn to page seven and focusing on Integrated Solutions, this area is former telecom. Now we are expanding into new market segments since a few years, creating a stronger platform and less volatility. If we turn to page eight, we will see the split up of the different parts of the businesses. On the right-hand side, we will see the EMC thermal part of the business, and on the left-hand side, the Consumer Electronics part of the business.

**Christer Wahlquist**

President and CEO | Nolato

If we then go into page nine, focusing on details for Integrated Solutions during third quarter, we saw about 50% decrease in sales. If we adjust that for currency, the decrease was some 60%. This was affected in part by end-market and end-customer demand affected by the situation in Eastern Europe with Russia's invasion of Ukraine, but also by the dual sourcing on our VHP side. We have a licensing underway due to new regulatory requirements for the VHP products in China. In October so far, we have had no manufacturing of VHP products.

**Christer Wahlquist**

President and CEO | Nolato

EMC is continuing to perform well, and we estimate the fourth quarter to be in the region of half a billion SEK in sales due to lower VHP volumes, corresponding to the situation with the new regulatory requirements in China for VHP. The margin ended up at 10.3% and of course affected by the lower volumes produced during the quarter. Sales ended up at SEK 745 million and the operating profit EBITA at SEK 77 million, creating the margin of 10.3%. If we then turn to page 10, focusing on the Industrial Solutions business area. On this business area, we are on the technology and geographical expansion journey, creating a good production footprint in the three important continents of our business.



Christer Wahlquist
President and CEO | Nolato

Turn to page 11, looking into the business area Industrial Solutions, we have two parts to this business. We have the larger portion, called General Industry, which is products for household, white goods, and furniture and other industrial areas. Then we have the Automotive Industry focusing on the car manufacturing, but also on the heavy vehicles. Turning to page 12, focusing on the details of the third quarter for Industrial Solutions. During the quarter, we saw an 18% increase in sales, and if we adjust that for currency, end up at 9%. Of course, charging of high costs contributed positively to the sales numbers, and we see continued healthy volumes in general, but indications of reduced demand looking ahead of time.



Christer Wahlquist
President and CEO | Nolato

The EBITDA margin ended up at 5.2% and was affected by fluctuation call-off orders, resulting in low operating efficiency, especially for the automotive industry, and also with a time lag in charging on cost increases towards our customers. In the third quarter, the sales ended up at SEK 638 million, with an operating profit, EBITA, of SEK 33 million, creating the margin of 5.2%.



Per-Ola Holmström
EVP and CFO | Nolato

Good afternoon, Per-Ola Holmström, and I will comment on group financial numbers on page 13. Net sales decreased in the quarter and totaled SEK 2.6 billion compared to SEK 3.0 billion, the same quarter previous year. The EBITA margin was adverse with 3.1% compared to Q3 last year being 8.1%. The lower margin affected profit negatively in combination with lower sales, mainly VHP. Operating profit was SEK 214 million compared to SEK 339 million, the same quarter last year. Cash flow after investments increased compared to latest quarters and the same quarter last year to SEK 166 million. Net investments decreased to SEK 109 million, and working capital was almost neutral.



Per-Ola Holmström
EVP and CFO | Nolato

The full year CapEx last year was SEK 782 million, and we reiterate the full year CapEx this year between SEK 600 million-SEK 750 million, depending on when we pay for real estate in Sweden. Earnings per share were SEK 0.59 compared to SEK 0.95, previous year, the same quarter. Net financial liabilities decreased further this quarter to SEK 580 million when excluding pension and lease liabilities.



Per-Ola Holmström
EVP and CFO | Nolato

Turning to page 14 and some comment on the current situation for our business area. If we start with the Medical Solutions, we have a maintained growth strategy, a lot of focus on innovation based on strong customer relationships, but we also have the inflationary effects. If we look into Integrated Solutions, we have established a position in the new product areas based on our flexible production structure. We see the 5G rollout and new initiatives in the automotive sector that are very positive for our EMC business. We have some geopolitical concerns, and of course, the Chinese license procedure is ongoing within the VHP. On the Industrial Solutions side, we have advanced our market positions. We are impacted by supply chain disruptions, mainly at our customers. We emphasize on our sustainable solutions and of course, the inflationary effects affecting.



Per-Ola Holmström
EVP and CFO | Nolato

We now open up for questions.

Q&A

**Operator**

Thank you. If you wish to ask a question, please press zero one on your telephone keypad. If you wish to withdraw your question, you may do so by pressing zero two to cancel. Our first question comes from Adrian Gilani from ABG. Please go ahead. The line is now open.

**Adrian Gilani**

Equity Research Analyst | ABG

Yeah. Hi, it's Adrian here at ABG. A few questions from my end. First of all, one regarding input costs. Obviously, we've seen both sort of oil and gas come down quite significantly from peak levels earlier this year. You had already made clear this wasn't going to affect Q3, so no surprises there. How should we sort of think going forward? Is Q4 still too early, or should we start seeing a positive impact from decreasing input costs already in Q4?

**Christer Wahlquist**

President and CEO | Nolato

I think Q4 will not show much decrease. As you say, we have seen some effects of this kind of cost flattening out. One thing to remember is when we look into the different indexes showing price developments, often there are surcharges to those which adds on to the pure material cost. There are, for example, surcharges for energy, which we think will increase going forward.

**Adrian Gilani**

Equity Research Analyst | ABG

Okay. That makes sense. Can you just remind us, at some point, the current cost levels seem a bit unsustainable. In a scenario where they eventually go down, how long have you historically been able to sort of keep your elevated prices to customers?

**Christer Wahlquist**

President and CEO | Nolato

In many cases there are transparency, but, of course, as we have time lags, there will be time lags in the opposite direction as well. Some kind of time lag, I would expect, also in that direction.

**Adrian Gilani**

Equity Research Analyst | ABG

Okay. If we look at Medical Solutions, you've said for several quarters that the sales mix in medical has had a negative effect on margins. You've talked about sort of destocking effects in your high margin segments, IVD, for example. Presumably this as well has to turn around at some point. How should we think on this, on the sales mix in medical for the coming few quarters? When are these IVD inventories starting to sort of become depleted?

**Christer Wahlquist**

President and CEO | Nolato

We don't have full transparency of this since those stocks are in different levels in the downstream supply chain. I agree with you, it cannot stay forever. So far we have not seen indications of easing up of that stock level.

**Adrian Gilani**

Equity Research Analyst | ABG

Okay. Just to be clear, how long is your visibility? If you haven't seen it now, does that mean not only Q4 we won't see it, but also maybe in Q1? Or is it too early to talk about Q1 at all?

**Christer Wahlquist**

President and CEO | Nolato

We don't know. We of course have visibility on our order situation. We have long term plans together with the customer. Of course the call offs are on the shorter horizon. It could start happening late Q4. It could start happening in Q1. We don't exactly know.

**Adrian Gilani**

Equity Research Analyst | ABG

Okay. Then I assume that once the IVD volumes do return, that that's also going to significantly sort of improve capacity utilization. It will be sort of a double effect, positive effect on margins. Are there other areas with low demand in medical that we should be aware of as well other than IVD?

**Christer Wahlquist**
President and CEO | Nolato

I would say that the low volumes are within the IVD sector if we look on the medical side.

**Adrian Gilani**
Equity Research Analyst | ABG

Okay. On integrated, the whole permit situation that you recently came out with, your customer in VHP, while you are not able to produce, can they sort of compensate for those lost volumes through their other sourcing partner? Or is this other partner in the same situation where they're also waiting for a Chinese permit?

**Christer Wahlquist**
President and CEO | Nolato

We don't have the full visibility on the supply chain, but so we don't exactly know how that is affecting. It's been going on for October so far, and we expect to get our license. Our best estimate is during November.

**Adrian Gilani**
Equity Research Analyst | ABG

Okay. I assume that in Q4 for you guys, there will be some significant inventory buildup due to not being able to produce as planned. Is that reasonable to assume?

**Christer Wahlquist**
President and CEO | Nolato

Yeah. We are of course evaluating the situation every day, so to say. Did you mean inventory buildup?

**Adrian Gilani**
Equity Research Analyst | ABG

For you, since you cannot produce. I assume that the components are already with you, and you'll just have to sit on them for now.

**Christer Wahlquist**
President and CEO | Nolato

Yeah, that's right. We are of course trying to stop as much as we can. We have seen some effect of that, and there is still some going on. Of course we try to adjust, and there are certain possibilities to that. Overall it is increasing our inventories. Yes.

**Adrian Gilani**
Equity Research Analyst | ABG

Okay. In that case, that was all for me. Thanks for answering my questions.

**Christer Wahlquist**
President and CEO | Nolato

Thank you.

**Operator**

Thank you. The next question comes from Carl Ragnerstam from Nordea. Please go ahead. Your line is now open.

**Carl Ragnerstam**
Managing Director and Head of Small Cap Research | Nordea

Hi, it's Carl from Nordea. So firstly on Industrial, I mean, we have seen sort of falling margins for quite a while now, right? I mean, have you any measures in place how to sort of restore margin? Because looking at the trailing margins, it's we haven't seen these levels since, I mean, the financial crisis basically. Also with Volvo's production stop next week in October, or one week, sorry. I mean, should we expect an even worsening situation in Q4 in Industrial Solutions or? How should we look at it?

**Christer Wahlquist**
President and CEO | Nolato

The main reason for our low margins, of course, the volatility and the call-offs from our customer on the short horizon, such as the one you mentioned now coming in next week. That is the biggest thing affecting our margin. Of course we have the cost increase, and the price increases towards the customer with the lag effect. I think, we have to get those volumes stabilized in order to get the margin where we want it.

**Carl Ragnerstam**

Managing Director and Head of Small Cap Research | Nordea

Okay, it's purely volume related. You're not planning to do anything on the cost side of it?

**Christer Wahlquist**

President and CEO | Nolato

No. It's basically it's coming from the sluggish volumes and, you know, Nolato is always in a position where we honor our customer and try to be the best partner long-term for them. If we would take away a lot of people, then we would not be able to follow the needs for our customers. We are in this together with our customers.

**Carl Ragnerstam**

Managing Director and Head of Small Cap Research | Nordea

Okay. That's also fine. On the medical side, quite thin margin in the quarter. Is it possible to sort of quantify or try to split up the negative effects, year over year here in the quarter?

**Christer Wahlquist**

President and CEO | Nolato

Yes, we can comment on that. There are some different effects affecting the margins, and we have mentioned those in the report. I would say that the two biggest ones and they are similar in size, almost 1% each, and those come from the time lag and the effects of the increased purchase pricing, increased labor costs, increased energy costs going on, which we have commented for quite some time. The mix effect is the other larger effect coming from less IVD and more surgery. There is a slight effect coming from not fully utilized investments made 2021.

**Carl Ragnerstam**

Managing Director and Head of Small Cap Research | Nordea

Okay. Super helpful. Also, I mean, what you said you had a negative margin mix. I mean, you also said that surgical is seemingly growing, and I suppose it's partly GW Plastics in that. It looks like you have some margin pressure in GW Plastics as well, right? Or is it a miscalculation from my side?

**Christer Wahlquist**

President and CEO | Nolato

That is correct. I mean, as you know, they come from a lower margin than we used to have. Then of course, they run into the same kind of problems with the higher cost situation as we have in that business area, totally. They have seen the same effects from raw material, energy and labor costs. The labor cost effect is the highest in the U.S., when compared to where we have production.

**Carl Ragnerstam**

Managing Director and Head of Small Cap Research | Nordea

Okay. That is also super helpful. The final one from my side is on EMC. It is actually growing quite nicely year-over-year, about 20%. Could you help us split up the main drivers? You have automotive, you obviously have telecom as well.

**Christer Wahlquist**

President and CEO | Nolato

Yes. We see growth across all parts of EMC business. Of course, automotive is a newer segment for us. In percentages, it's growing faster than the total. We see good growth across.

**Carl Ragnerstam**

Managing Director and Head of Small Cap Research | Nordea

Okay. Super. Thank you.

**Christer Wahlquist**

President and CEO | Nolato

Thank you.

**Operator**

Thank you. The next question comes from Johan Skoglund from DNB Markets. Please go ahead. Your line is now open.

**Johan Skoglund**

Equity Research Analyst | DNB Markets

Hi, and thank you for the presentation. Now, I read a comment in the report saying that dual sourcing is now in effect. Could you please, in broad terms, elaborate a bit what this will mean in terms of price and volume going forward? Is it like only you and another actor, or do you know if there are several? I understand if you don't have all the details, we can share them, but some color would be helpful.

**Christer Wahlquist**

President and CEO | Nolato

Yeah. We have earlier commented that the old product that is not affected by other sourcing. Since the customer has changed sourcing strategy for new products, there are sourcing from other parties, and that is affecting going forward. That is somehow also one effect that we have calculated when we do the estimate for the fourth quarter.

**Johan Skoglund**

Equity Research Analyst | DNB Markets

Okay, understood. Thank you. For some looking ahead then, you mentioned robotic surgery on your capital markets day. I know we discussed this a few weeks ago as well, but can you please talk a bit more about the future opportunities in this segment?

**Christer Wahlquist**

President and CEO | Nolato

Generally in medical or do you mean automated surgery specifically?

**Johan Skoglund**

Equity Research Analyst | DNB Markets

Robotic or automated surgery specifically. Thanks.

**Christer Wahlquist**

President and CEO | Nolato

Okay. Yes. Okay. We see a change of the surgical business going forward, and it's gonna be more and more robotics. This is of course creating opportunities with more advanced, how should I say, devices for that. We think this is gonna be an interesting area to be in, and a growth area. We are, I would say, well-positioned within the robotic surgery. You should always remember that in medical, there are slow changes, and it's more a step-by-step change than anything else.

**Johan Skoglund**

Equity Research Analyst | DNB Markets

Okay, thank you.

**Christer Wahlquist**

President and CEO | Nolato

Thank you.

**Operator**

Thank you. The next question comes from Michael Lofgren from Carnegie. Please go ahead. Your line is now open.

**Michael Lofgren**

Research Analyst | Carnegie

Thank you. Three questions. First of all, can you say something about the indications for lower demand that you highlight in the report? What indications are you referring to and in which areas, and maybe something about the magnitude?

**Christer Wahlquist**

President and CEO | Nolato

Yes. This is more of a forward-looking statement. Of course, as we described earlier, we have short-term plans, long-term plans, and medium-term plans with our customers. On some of the industrial side customers, we get those signals that it might be some lower margins going ahead. It's nothing that we see in our order books or anything like that. It's more, maybe during next year.



Michael Lofgren
Research Analyst | Carnegie

Okay. They plan for slightly lower volumes, I guess. That's what you're seeing.



Christer Wahlquist
President and CEO | Nolato

Yes.



Michael Lofgren
Research Analyst | Carnegie

When it comes to Integrated Solutions and their guidance for Q4 of SEK 500 million, can you say something about a margin impact? Do you expect to be at this level that you had in Q3, or will there be other effects coming in and a lower margin, therefore?



Christer Wahlquist
President and CEO | Nolato

Well, the low volumes, and as we state, those are, of course, affecting VHP. Having those low volumes that we have during the fourth quarter is doing that. We, of course, do not earn much money on that part. There might be a small loss in that part because of that. We have the EMC part, and you know, we give the sales numbers for that. That has become a larger part, of course, of the total business area. We have premium margins in that part, which is then supporting the total margin. We have other products outside VHP within consumer electronics, where we have more general level of margins.



Christer Wahlquist
President and CEO | Nolato

Summarizing these three areas, I do expect a lower margin during Q4 in Integrated Solutions because of that. It won't be a double-digit margin.



Michael Lofgren
Research Analyst | Carnegie

Okay. Yeah, that makes sense. Thank you for that clarity. My final one is on Medical Solutions. On page five, you have the product areas. Would be great if you can maybe say something about the growth for these different segments. We understand that IVD is declining probably, but can you give some indications of how much they grow in the Q3?



Christer Wahlquist
President and CEO | Nolato

Oh, yes.



Michael Lofgren
Research Analyst | Carnegie

Thanks.



Christer Wahlquist
President and CEO | Nolato

As a general rule of thumb, the medical market is growing 3%-4%. If we look into the different segments, I would say faster growing on the fast growth side, Drug Delivery would be one of those. In the long term, I think also the in vitro diagnostics would be higher growth than that in average, and not right now, but over time. Then, of course, we expect Endoscopy and General Surgery to be on the higher growth rate, but of course, with the robotics coming in.



Michael Lofgren
Research Analyst | Carnegie

Okay. What did you see in Q3? Is surgery growing really fast from lower levels, or is it developing in line with what you've indicated? I guess it must be, but I'm not quite.



Christer Wahlquist
President and CEO | Nolato

Yeah. Yeah. If we take Endoscopy and General Surgery in this third quarter, we have lower comparison number during 2021 due to the pandemic. Of course, the growth rate of that was higher than normal, but it was more due to a lower Q3 last year.



Michael Lofgren
Research Analyst | Carnegie

The split of the segment for product area, is that a good representation that you have on the slide? That IVD is roughly 18% in Q3.



Christer Wahlquist
President and CEO | Nolato

It's not corresponding to this third quarter. It's more, an yearly overview.



Michael Lofgren
Research Analyst | Carnegie

Okay. It's not significantly different, right?



Christer Wahlquist
President and CEO | Nolato

Of course, during the third quarter, we had some lower IVD, as we commented. That would be maybe a little bit lower during the third quarter.



Michael Lofgren
Research Analyst | Carnegie

All right. Thank you.



Christer Wahlquist
President and CEO | Nolato

Thank you.



Operator

Thank you. No further questions at this time. I hand over the word back to you, Christer and Per-Ola, for any closing remarks.



Christer Wahlquist
President and CEO | Nolato

I would just like to thank you all for your interest in Nolato and listening to us presenting the third quarter. Thank you, and I wish you a very good rest of your day.