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Storskogen Group AB (STOR.SE)

Q3 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Daniel Samuel Kaplan

Co-Founder & Chief Executive Officer, Storskogen Group AB

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

So, starting off with a brief introduction of Storskogen. We are an international group of businesses across Trade, Industry and Services. We have 14 different verticals, no single vertical more than 16%, no single company more than 6%. So, we are uniquely positioned to identify, acquire and develop market-leading companies with sustainable business models with an infinite ownership horizon.

Currently, we have SEK 36.5 billion in turnover and SEK 3.5 billion in RTM EBITA. Going into our third quarter and the third quarter highlights, you can see that we had sales of about SEK 8.4 billion. This is 77% up, which is, of course, very strong and we're happy with that. 12.4% of that was organic EBITA sales growth and not EBITA sales growth, whereas the organic EBITA growth was minus 5.5%. If we're looking at the adjusted EBITA, that was SEK 772 million. This is 57% up towards last year, giving us a margin of 9.2%.

If we're looking at the key events in the quarter, we've done four acquisitions, with an additional four actually made after the quarter. We have a new unsecured syndicated term loan facility of approximately €300 million. We're very happy to have that as well going forward. And finally, if we're looking ahead, our strategic focus for the time to come, approaching a more uncertain environment, we will have focus on operational excellence, a strong balance sheet, as well as cash flows. Our current pipeline of acquisitions, we have five LOIs and processes where we are the preferred buyer.

So, looking more into the numbers, we have the net sales and EBITA margin. As we said before, SEK 8.4 billion in sales. This is 77% stronger than last year. We can see that sales growth has been strong in the quarter. But of course, partly driven by acquisitions, but also strong demand in the market, especially within Industry and

Services. If we take the EBITA margin, this was negatively impacted by currency headwinds, cost inflation, such as material costs, et cetera. But this was partially offset by successful price increases towards our own customers, of course, cost efficiency measures, and the good underlying market.

Talking more about the market development and our M&A activities in that market. We see a solid demand in Industry and Services, with successful price increases from us towards our customers, upholding margins as well. We can also see that supply chain disruptions are diminishing, which makes life a lot easier for us operationally, also enabling us to gradually recapture margins as well.

However, we have suffered from very weak Swedish currency and also the pound has developed poorly, especially against the dollar, which has decreased our own margin. We also see weakening demand in certain consumer-facing categories as well, both in Trade and in Industry.

If we're looking at – looking ahead, we have our fourth quarter which is seasonally stronger. We don't give any guidance until 2023. It's certainly an uncertain world out there. But I can reiterate our seasonality, which is a weaker first quarter, a stronger second quarter, once again, a weaker third quarter and a strong fourth quarter. And that's what we are expecting for next year. Of course, with the backdrop of a potential recession coming in, I would say.

If we're looking at the transaction market, it has slowed down somewhat as it always does when price volatility is higher. We can see bigger spread in multiples across different industries and geographies, which is actually benefiting us greatly since we are active in many industries and geographies. But from – when it comes to Storskogen, we have actually established now organization – stronger organizations out in the world and these are driving systematically deal flow. So, in fact, we have never seen a stronger deal from [ph] them than (00:05:15) we've had this year so far.

When it comes to our short-term priorities, I already mentioned, a focus on strong cash flows, operational excellence and also our balance sheet. And I should say that, the huge deal flow that we have, but also our calibrated acquisition pace, enables us to be even more selective than we have been previously. So this is, of course, a great opportunity for us.

If we're looking at our financial targets and our performance towards those, first is, of course, organic EBITA growth. We're targeting a real GDP, plus 1 percentage point to 2 percentage points. And this is, I should say, over a business cycle in the medium term. And this counts for all of the financial targets, assuming access to capital, for example, and functioning both debt and equity markets.

So, if we're looking at the organic EBITA growth, it's been 5-point – minus 5.5% so far this year. This is, of course, not satisfactory, but it does illustrate the fact that we have had extremely strong comparison numbers. We had 36% organic EBITA growth last year. So, it was actually the very peak, almost boosted as well by the post-COVID boom, you might say. So, very strong comparison number, nevertheless, not really satisfactory and also shows the very difficult environment that – so despite strong demand, we've had all of these – the COVID close downs, the currency headwinds, material shortages, et cetera, et cetera.

So, if we're looking at our total EBITA growth including acquisitions, this is to be in line with historical levels over a business cycle. So, currently, 94%, very strong, actually significantly above our historical average. That said, of course, this will decrease as we are reducing our acquisition pace and we'll be looking at tougher times ahead as well. But this will fluctuate around our targets over the business cycle. When it comes to our EBITA margin targets of 10%, we're currently at 9.1% for the last 12 months. Once again, not satisfactory, but not surprising given the fact the many operational challenges we've had this year.

Looking at our cash conversion, we are targeting 70%. Currently, we are at 50%, a strong positive change, sequential improvement since before. But that said, we are doing a lot and lot of activities to improve this over time. If you look closely, this quarter was significantly stronger than we had last year at the same period. But that said, I think we have lots of work to do here. It will take some time, but I'm sure that we will improve this over time.

Finally, our net leverage – interest-bearing net debt to EBITA, our target is to have – to be between 2 times to 3 times. We've finally come to the point where we've deployed most of the capital that we raised in the IPO, making those – that money productive. And normally, I would be extremely satisfied with 2.7 times, I should say, moving into uncertain times. We have decided to decrease our leverage over time below 2.5 times for sure, potentially even lower as the next year comes along. So, that's our ambition on leverage.

If we look at each and every single business area, of course, we have Services with strong sales growth, with sequential improving margin. We finally kind of turned the tide in Services with – for quite some time now, Digital Services, Logistics have performed really, really well. But in this case as well, we can see that Installation is finally improving, meeting their targets to a greater extent. Solid demand, overall strong sales growth despite actually the holiday season coming, of course, in July and August.

We can see some stabilization of inbound prices on materials, which also makes it and also, for example, fuel, which makes it easier for us to price our projects and move on prices to our customers. There is an uncertain economic future ahead of us, so we don't want to give too much guidance into next year. But we know for a fact that Services is a quite resilient business area. So, we have great confidence anyway in this business area. We did one acquisition in the quarter. We'll get in more to that later on in the presentation.

If we're looking at Trade, this is the business area which had the toughest time during our quarter. The organic sales growth was 5%, but the organic EBITA growth was minus 15% year-to-date. Demand was dampened by currency headwind, but you could also see specific consumer-facing industries losing demand as well as our e-commerce company suffering as well from the post-COVID normalization, you might say.

Good demand in Health and Beauty vertical, for example, which is more and more important, as you can see. The price increases from our acquisition – from our purchases was partly offset by us managing to push on prices towards our customers as well. So, that has been relatively satisfactory, I should say. This, of course, is a seasonality thing. So, in the third quarter, we usually build inventory for the fourth quarter as well. So, that said, I think they are starting to work with their cap – with their working capital. So, it's – they're still elevated, but they're improving and we're looking at greater improvements going forward. Strategically, lots of good things are happening now for our Trade companies. During the Capital Markets Day, we mentioned HAIR CO, the merger of three of our hair care distributors, but we also did a few acquisitions within that area, which I'll get into more later on.

So, moving on to Industry. We see a continued strong development with organic EBITA growth of 11% year-to-date. We see margins holding up and demand quite strong, especially Industrial Technology as well as in Automation, where we're really benefiting from the re-shoring trend as people move back their production from Asia and elsewhere to Europe.

If we're looking ahead, I think we do have very strong order books. But on the other hand, we are anticipating a tougher business cycle next year with low visibility for 2023, but still good trading as far as we know. We've done two acquisitions so far this year – this quarter. They were both in Sweden and are a part of Industrial Technology and Automation.

Lena?

Lena Paulina Glader

Chief Financial Officer, Storskogen Group AB

Well, thank you, Daniel. So, let's have a closer look at the Q3 number now. Daniel already mentioned the 77% year-on-year growth in terms of net sales in Q3, where net sales is now SEK 8.4 billion. At the – looking at the LTM period, now, that's again our owned period, then, net sales for that last 12-month period shown as LTM here is SEK 30 billion and RTM, which is again pro forma, had we owned the companies the entire 12-month period, then that sales is SEK 36 billion.

EBITA grew by 57% to SEK 772 million, with LTM EBITA of SEK 2.8 billion and pro forma RTM EBITA of SEK 3.5 billion. Now, the Q3 SEK 772 million in terms of EBITA corresponds to a margin of 9.2%, which is lower than last year's 10.4%. And why is the margin down year-on-year? Well, Daniel already mentioned the higher cost base, the negative contribution from the weak SEK or rather the strong US dollar, which does impact especially the Trade business area where a large part of the purchases is in US dollar and a large part of the sales is in SEK.

And then, of course, thirdly, we have the slightly slower sales in those Trade companies, with mostly e-commerce customers. EPS grew by 30% year-on-year to SEK 0.26 per share and return on equity was 9%. Return on capital employed was 10%, which is a slight improvement from Q3 last year. And both metrics are, of course, again diluted by the strong growth this past 12 months. Should we deduct cash from the return on capital employed? So, return on capital employed net of cash, then that is 12% for the last 12-month period.

We had cash flow from operating activities, as shown in the cash flow statement, of SEK 204 million in Q3, a clear improvement again from year-on-year from Q3 last year where we had some one-off negative effects there. But the last 12 months cash flow is nevertheless SEK 1.1 billion during the last 12-month period, as I said. And I'll come back to both cash conversion and net debt in just a little while.

So, first, let's have a look at the pro forma EBITA bridge that we usually show here. Now, this shows again the run rate EBITA or the pro forma as it stands today and as it would stand with the current pipeline. So, starting off with the LTM EBITA of SEK 2.8 billion as shown on the previous page on the RTM the pro forma of SEK 3.5 billion. Now, the difference here is, of course, the EBITA contribution from the companies that we have not owned during the entire 12-month period there.

We made four acquisitions after the end of Q3 up until today, contributing another SEK 97 million in terms of EBITA. And the largest of these is CMTi in Singapore acquired in October, really good profitability there as well. So, pro forma today would be 3-point – including this would be SEK 3.6 billion. And the LOI pipeline includes another SEK 39 million in terms of EBITA.

So, let's move over to cash flow. Here, we show the operating cash flow, defined as EBITA, less change in net working capital, less CapEx. And then, the cash conversion, which is defined as this operating cash flow over the EBITA. So, essentially, how much cash is generated out of the operating activities in Storskogen. Operating cash flow was SEK 1.8 billion for the last 12-month period. And as you see here on this graph, this is, in fact, the highest level during these past eight quarters, despite the fact that we have tied up more net working capital than during any other normal period.

And net working capital is, as Daniel mentioned here before, is, of course, affected by high inventories, following a fairly long period of supply delays and material shortages, which we have mitigated by keeping above normal inventories. And now, these problems, as you said, Daniel, are diminishing, which means we can slowly start to get back to normal levels. However, there are people out there who believe that the new normal level will be slightly higher than the recent pre-COVID years.

But actually, the change in net working capital is more affected by lower payables than by inventory buildup. And this we might see during the coming periods that the payables come down as companies reduce their procurement in order to reduce their inventories, right. So, cash conversion here is 48% for the quarter and 50% for the LTM period, which is again, below the 70% target, but a significant improvement from Q2 when it was 32%.

And then, finally, net debt and leverage. So, showing here is the interest-bearing net debt and leverage, which is defined as interest-bearing net debt over EBITA, obviously. Now, EBIT – interest-bearing net debt was SEK 12.7 billion at the end of the quarter, which is an increase of SEK 0.6 billion, and this increase is a result of the four acquisitions, albeit smaller ones, that were made during the quarter, as well as some buyback of minorities and paid earn-outs during the period.

Leverage was 2.7 times, which is again within the target range of 2 times to 3 times, but with a clear ambition, as you just heard from our CEO here, to reduce it. But leverage was also affected by lower RTM EBITA. That has reduced since Q2 by approximately SEK 100 million. And why is that? Well, the reason for that is that last year's Q3 was very strong quarter and not perhaps normal in a seasonal way, whereas Q3 this year is more normal seasonally again. And also, this year's Q3 EBITA is affected by these currency headwinds and higher cost levels, et cetera. So, it is below potential.

So, what we're looking at here is the RTM – is in the RTM EBITA, we're rolling out a strong quarter and rolling in a more seasonally normal quarter, with profitability below potential we would say. Our total available liquidity at the end of Q3 was – is SEK 9.4 billion, where a SEK 3.2 billion in cash at bank and SEK 6.3 billion in unutilized credit facility. And Daniel already mentioned the new term loan of €300 million signed just at the end of the quarter.

So, back to you, Daniel.

Daniel Samuel Kaplan

Co-Founder & Chief Executive Officer, Storskogen Group AB

Thank you, Lena. So, very briefly touching upon our completed acquisitions in the quarter. One was Xodbox. Xodbox is a media advertising and graphic design service, situated in Singapore. They're profitable government customers and also experiencing strong growth since a while back. So, a good contribution to our Digital Services vertical, which is overall performing very strongly, I should say.

Another one of our acquisitions was Vox Concept (sic) [Vox Hair Concept] (00:22:11). This is a hair salons in Norway. We see it as a great addition to our Beauty and Health – Health and Beauty vertical. So, a great and interesting acquisition in that one. And after the quarter, we also bought, Cutrin, which will be a part of our Health and Beauty vertical as well. So, we're continuing that work to consolidate that market both horizontally and vertically.

Finally, if we look at the Industry, we have Löfqvist Engineering. This is an acquisition process that we've been working at for probably eight years or something like that. It's an automation company doing process lines and automation solutions. It's a great company. And as you know, our Automation vertical has been performing really well for quite some time now over the years. So, we really want to strengthen that vertical over time as well.

After the quarter, we will tell you more about that in our next quarterly report, the acquisition of CMTi in Singapore with production in Indonesia, producing cable harnesses, very niche product where they're market leaders against – towards the medtech industry; profitable, growing, long and strong customer relationship and relatively resilient towards various variations in the business cycle movements, for example. So, these are a few of the acquisitions that we've made this quarter and also after the quarter period.

We have talked a little bit about our operational excellence. And for those of you who participated in the Capital Markets Day, you know all about the KX. So, I will touch upon this very briefly. We have 12,500 employees with lots of expertise. We are pooling that expertise on a joint platform where we have events, speakers. We have case studies, frame agreements, et cetera, within a range of different areas from pricing to ESG issues. And this is something that happens every day continuously, not only the CEOs and the headquarters, but also all our employees are involved with their different specialties.

If we're just drilling down into one of these, this is procurement. We currently have 12 work streams in procurement, working with everything from freight to insurance. And of course, we're more or less twice the size than we were last year with regard to sales, but also with regard to purchasing. And this gives us a tremendous purchasing power. So even, of course, we are decentralized, each and every company needs to choose their own suppliers and be responsible for that. This means that we, by offering them frame agreements, they get great benchmarks, but they can also tag along and they get some important purchases through us, together with us at a better price. And this is, of course, low-hanging fruit. But I think over time, this will be very concrete margin improvement activities. That's just one blink into – one view into our operational excellence work at the moment.

So, before we move into Q&A, I wanted to mention that we had a Capital Markets Day by the end of September. For those who couldn't attend, you will find lots of great video footage from that, myself talking about our strategy, our vision, and how we work with operational excellence. Lena will talk about our historical performance of our companies, how we work with the working capital, et cetera, et cetera, so a lot of things on the financial side.

Our three business areas will really give you some understanding on how do we work with these companies, how do we manage them, what is our strategy, and our work with over-performers, growth companies and on acquisitions and low performers, how do we work with those companies. I think you will get some really interesting insights both on how we do it and also the actual industries where we're at. And finally, of course, my fellow Co-Founder, Alexander Bjärgård, will talk about our M&A process, how we're thinking with acquisitions and building up portfolio as well, our capital allocation principles, and how we prioritize now when we have between the many different acquisitions that we can make over time.

So, in conclusion, I think we are relatively happy with our performance in the quarter. We've had a challenging environment with especially currency headwinds, but also the gradual after effects of COVID, supply chain disruptions and, of course, the inflation. But – so it's been a mixed picture from a demand perspective, strong in Industry, decent in Services and weak in Trade. And this is, of course, one of the good things about having a portfolio that we are, of course, diversified and can manage all the shifts in a business cycle, as well as in the macro and micro environment. We have started to execute our calibrated M&A pace as gradually a slower pace, I would say, even though we've done a few strategically important acquisitions, which we're very happy with.

With cash flow, this is, of course, our top priority going forward. You've seen a strong sequential improvement, but that said, lots of more work to do and I hope to give you more progress on that area going forward as well. So, in the future now, in the next year to come, operational excellence is one of our key focus areas, a strong cash flow and a strong balance sheet.

So, now, over to the operator for some Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question comes from Carl Ragnerstam from Nordea. Please go ahead.

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions

Q

Good morning. It's Carl here from Nordea. A few questions. Firstly, with central costs falling a bit sequentially here, you also took charges for restructuring. So, I wonder, I mean, how much of the reduction of central costs sequentially is actually lower number FTEs? And how much is that you might have pushed out central functions, resources to subsidiaries and I guess by that they could be allocated to the segments instead.

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

A

In short, the lower cost in the third quarter was partially due to vacation effect, et cetera. We have done some reductions. We have pushed out costs, like you said, into our operations. That said, some of those reductions actually take some time before they take effect. So, we would probably have a somewhat of a bump back of central costs in the fourth quarter. And then, in the – in next year, we will have a lower ongoing level with regard to our cost level. And without being too explicit, I think we can say – safely say that it's going to be less than 1% of sales for the next year.

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions

Q

Okay. Very good. Should we expect more restructuring costs in Q4 as well or are you done for now?

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

A

I think we are – when it comes to the central operations, we are certainly done. I think when it comes to our portfolio companies and all our joint efforts, when it comes to procurement, i.e., purchasing and all kinds of other efficiency measures as restructuring, I think that is continuous and well, it's different for different business units out there. So, I think that will probably continue throughout next year as long as it's required in the operations out there. So, I think, I mean, central costs in comparisons are very small portion of our total cost base. So, I think it's the ones out in operations that really count.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

And accounting wise, we took the cost now in Q3. That's right.

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions

Q

Okay. Very good. And also, a bit on sort of the cash flow side of it. You have, I think, close to SEK 600 million in earn-outs due in the coming 12 months. How much of that would you – do you expect to materialize? And could you also give some comment on the remaining, which is due in more than 12 months – what you can see right now at least?

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

A

I think, I mean, it's difficult to assess. I think it depends on the operational performance. I think going into a potential recession, I think we can safely say that earn-outs will be, well, materializing to a lesser extent than in a really good business cycle, we can say that. On the other hand, we are continuously kind of re-evaluating the potential earn-outs going forward. So, we're trying to be as – correcting and estimating that as possible, I think, being a little bit conservative, I should say. I'm not sure if you have more to add on that?

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

No, that's completely right.

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

A

Yeah.

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions

Q

Okay. And the SEK 600 million in the near term, those will be paid out, I guess, then, or...

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

That is the current estimate when we closed the Q3. Yes.

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

A

Yeah.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

So, we'll have to revalue those, of course, again in Q4 and in Q1 and so forth, so going forward, with – as we get new info...

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions

Q

Okay. Very good.

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

A

Yeah.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

...from the companies as well.

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions

Q

And I'm not sure if you gave the number, but is it possible to give the FX impact on Trade's EBITA margin in the quarter?

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

A

I think that's...

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

Yeah, sure. We don't report that separately, how much the FX impact is. What we can say is that it is, as you say, it's mainly the Trade business area that are affected negatively by this weak – the weak SEK, because a large part of their procurement is made in dollars and a large part of the sales is in SEK. But of course, as we are – more – getting more diversified geographically, this will, of course, slowly be more diversified as well. So, less effect. But we cannot unfortunately give you any exact number on that.

What we can say is that, of course, a large part of the negative FX is mitigated by pricing as well. So, we are – we have increased prices during the entire year first to mitigate or to offset the higher cost base, but also the negative FX. But as we always say, it takes some time to get those price increases through. But that is, of course, the ambition for all our subsidiaries is to protect the margin that way. We cannot always protect the margin 100%, especially not in the short term.

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions

Q

And in Services, you come from a period of, of course, high sick leaves in the beginning of the year, obviously raw material headwinds as well burdening the margin. Would you say that you are fully compensated by the raw material effects now in Q3 or you still had a slight headwind?

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

A

I think it's difficult to assess. I think most of our price increases have gone through in all our business areas. That said, we know that there are some lingering effects, other types of headwinds like fuel prices, et cetera, that kind of really actually burdened our margins in the first half of the year are gradually decreasing now. But it's actually difficult to assess exactly what remains, et cetera. But I think a certain lingering effect, I think, is still probably affecting the business, I would say.

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions

Q

And the final one from my side is a bit on divestitures. Have you made any divestitures so far or parts of any companies, or are you in the process of doing so right now?

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

A

We haven't done any divestitures. I can't really comment on the ongoing processes. This is going to be a continuous review of our portfolio, and it's not going to be any – I mean, if we are and when we do that, I will communicate on that as well. Potentially, I think it will be very minor in nature anyway.

Carl Ragnerstam
Analyst, Nordea Markets, Corporates & Institutions

Q

Okay. Thank you.

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

A

Yeah.

Operator: Thank you. Your next question comes from Andreas Koski from Exane BNP Paribas. Please go ahead.

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

A

Hi, Andreas.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Thank you and good morning. I hope you can hear me. I have a question on other operating income and expenses, because the net was positive by SEK 273 million in this quarter, and that can be compared to SEK 95 million in Q2 and SEK 171 million in Q1. So, what explains this significant increase in net other operating income expenses? How much of that impacted adjusted EBITA in the quarter and what to expect going forward?

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

Shall I take that? Hi, Andreas. That's a very good question; I'm glad you asked it. In the report on page 28, if I remember correctly, you will find a split out of the items affecting comparability that are adjusted in the EBITA. And that is a net of SEK 77 million, out of which, SEK 100 million is net, is an effect of revaluation of earn-outs and minority – or I'm sorry, earn-outs – earn-out revaluations going – dating back to the question that Carl just raised in the previous question. So, SEK 100 million is – as an effect of revaluation of earn-outs. And that is a net effect. So, the gross effect is more positive and then there is a negative as well. So, the net is SEK 100 million. And that makes out the largest part of this other operating income.

But also, in other operating income, you will always find items such as freight, or other costs that are forwarded. And so, that means that these are kind of income that we generate from customers for other services than the net sales item or product itself. It could be freight or rental income or items such as that. But the largest part is this revaluation of earn-outs, which is adjusted in the adjusted EBITA.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Okay. That's great. Thank you. And I guess you don't have a guidance to give on what to expect from this line going forward more than it's done and it should come down in the coming quarters.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

Well, the only guidance we can give on that is that these kinds of other operating income, I mean, that are a part of the businesses, but just not the net sales items such as rental income and other sorts of income, freight income, et cetera, those will always be a part of the businesses going forward. So, it'd always be a part of this on that line.

When it comes to the large part, which is the reevaluation of earn-out, now, that dates back to Carl's question before we do revalue the earn-out liabilities on a quarterly basis. And if those liabilities come down, then, that will be a positive effect. If those liabilities go up or increase, then that will be a negative effect on that line. But we – as we do it on a quarterly basis, I cannot give any guidance, because this is the best estimate that we have right now, which is in the report.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Yeah. And maybe just the last question on this topic. If you were to adjust for this revaluation, are you still happy with the underlying performance in Services and in Trade? Because I guess that's where we have the largest impact from this.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

Just to be clear, this item is adjusted, the revaluations. They are...

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Okay.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

So, in the adjusted EBITA that will – that you will look for in the report, that is excluding this revaluation effect.

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

A

Yeah.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Understood, understood. Then on the Trade segment, because I think Services and Industry performed well compared to my expectations and also compared to consensus, but Trade was probably the weakness in this quarter. How much of seasonality do we see in Trade and what do you expect in Q4? Is there normally a significant seasonal strengthening in Q4 compared to Q3...

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

A

I mean...

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

...for the Trade segment?

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

A

I think it's a very good question. I think, I mean, we do see seasonality. I think we are expecting seasonality both in Q3 and Q4, of course, and that counts certainly for Trade. That said, we do see some signals. We can see the entire value chain basically destocking at the moment. I think retailers with especially the consumer-facing products, they do try to take down their inventory and that, of course, affects our distributors as well. This is somewhat of a short-term effect, I should say. So, we're hoping to see a bounce back in demand some time during next year, even though I should say visibility for next year is of course relatively low, giving the volatile market condition.

So, we do see a seasonally strong Q4 even in Trade, but we are also seeing some signals in some of the Industry. Also, e-commerce, I should mention, where you have a gradually weakening demand. That's certainly so.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Okay. And then, lastly, on the net financial items. Would you say that is already reflecting the current interest rates, or should we expect net financial items to – they come up – or lower?

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

Oh, that's a good. Yeah, that's a good question. First of all, I'd like to point, I believe that, to, Andreas, already have looked at the report and we actually state in the text under the financial items section, how much of the net financial items is interest costs, which was, if I remember correctly, SEK 150 million or so in Q3. The rest of those are mostly FX related, as you say. I cannot tell right now, based on the current – this is largely SEK, Swiss franc and also parts of euro and pound values that are in there. So, I don't have the number on the top of my head, unfortunately, how that would affect [ph] that Q4 (00:43:07).

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Yeah. Okay. But do you think – okay, so you don't know or want to say if you think your current interest cost in Q3 reflect the current interest rates or [ph] if they'll really see a lag (00:43:23)...

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

Yes. Okay. So, we split...

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

...and that will impact.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

I'm sorry. I misunderstood the question. So, if we split out the interest rate, then the effective interest rate, if you look at the interest cost, which is SEK 150 million, if I remember correctly, and split that out on the average interest-bearing debt, then the effective rate would be somewhere around 3.9%, I think, in Q3, you would end up at. And so, that should be fairly correct or so. I mean, we have some hedges as well that are mitigating this cost. So, that will move as the short-term interest rate or STIBOR rather moves on a quarterly basis. So, if STIBOR rises, then that interest cost will come up slightly. It's not a 100% of it, which is tied to the short-term STIBOR rate, but a part of it is hedged and part of it is other, but quite a large part is [ph] capital (00:44:21).

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Understood.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

Yeah. But I was referring to the other items which are – that are quite large in the P&L that are FX related and those we cannot give any guidance on.

Andreas Koski
Analyst, Exane BNP Paribas SA (Sweden)

Q

Yeah. Understood. Thank you very much.

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

A

Thank you.

Operator: Thank you. [Operator Instructions] The next question comes from Karl-Johan Bonnevier from DNB Markets. Please go ahead.

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

A

Hi. Good morning.

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

Q

Yes. Good morning, Daniel and Lena. Just want to take [ph] your sense (00:45:02), to follow-up on working capital. I've listened to what you said, Lena. It sounded like you're not hopeful that you're going to be a big release in Q4 that it might slide into next year instead. Is that the right interpretation?

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

I'm not sure what gave you that impression. What I was saying is that the – we are working with inventories. And what I was saying is that even if inventories come down and we are successful in that way in releasing cash from lower inventories, you have other items in the working capital. So, if you reduce your procurement, then you would also reduce your payables, obviously, which would be a negative – short-term negative effect, which is actually what we saw in Q3, but with a negative payables effect.

And what happens if you sell is, of course, that you increase your receivables. So, what we do, what we work with is to reduce the whole value chain. So, reducing – keeping inventories at lower levels, which will first reduce payables and of course which might have a short-term negative effect, but in the longer term, it should have a positive effect with reduced inventories, especially because that has been the single largest item on the net working capital effect year to date.

So, I'm not saying that I'm pessimistic going forward at all. I'm just saying that there are just reducing the inventory will not necessarily help the cash flow in the short term. You will have to reduce to get to a lower level, of course, of receivables as well, and, yeah – and get the smaller change in the payables.

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

A

Yeah. But to be a little bit concrete, I think if we're talking about seasonality not only on a revenue generation, but also on things like cash, we know that the first and the third quarter are our weakest quarters where, for example, in the third quarter, we usually build inventory for – to be able to supply our customers in the fourth quarter, for example. And whereas, the second and the fourth quarter are usually stronger, basically both with regard to sales, profitability and cash flow. So, I think that we have that natural seasonality in all when we have now more normal patterns, you might say, than we had during the COVID years.

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

Q

Excellent. And then, I was a little afraid that we weren't going to see that normality as you describe it, Daniel. But I appreciate the granularity, so...

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

A

Yeah.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

Yeah.

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

Q

And then, just looking at the – your discussion on the gearing targets short term, getting below 2.5 times, is there anything you can do to speed up that process, because I guess you're still in the cycle where there is a natural kind of movement up in the RTM kind of the – of gearing level?

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

A

I think. I mean, there are lots of things that we can do. I think most importantly, it's of course to work with our working capital and [indiscernible] (00:48:19) that our cash flows both come off to our normal level. In addition to that, maybe potentially to get some of the elevated inventory levels and other levels to get those down to normal, which would actually release significant amounts of cash, even though I think that will probably take some time. So, I don't want to give you any guidance on when that will occur, but that is certainly our ambition.

And then, there is, of course, other activities as well that we might think about, but nothing that we really can or will guide on at this point. But hopefully, we will have a gradual pathway. I mean, we do have strong revenues, and I think we will get back to strong cash flows as well. And I think that will be quite sufficient in delivering over the year to come. Not to say the least since we're probably reducing our acquisition pace as well. So, that's one part of it.

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

Q

[ph] Exactly (00:49:17). And I appreciate all the granularity you have given us also on the outlook and the kind of [ph Trade (00:49:26) situation we are again standing in front of not really knowing what's happening, obviously, in the general economy. But when you – you said at the Capital Markets Day the Storskogen confidence indicator, when you look at that, Daniel, is there something that pops out of that that surprises you either on the upside or downside or where you see risk that you didn't think about or opportunities that you didn't think about?

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

A

I think when it comes to the positive side, I think we are – I think the third quarter was actually somewhat better than we anticipated. I think that we – when we look ahead, I think we were still, I wouldn't say, surprised, but we are happy to see that we still have stronger order books in the Industry, for example, and that our Services companies are still – both of those verticals that have stayed strong during the COVID period. And also, this year, like Digital Services and Logistics, they're continuing to perform strongly, but also that we see an uptick now in Installation and in some of the other sectors as well. I think that's certainly is promising.

I wouldn't say it's a surprise, but we certainly have experienced currency headwinds, for example, in Trade. I think that was – has had significant effects. I mean, they're doing lots of great work there. And of course, when the Swedish krona and also I think the British pound is performing as it has been towards the dollar, that of course, is an uphill battle that has affected profitability. I think that's for sure on the negative side.

I mean, going forward, we will have to see. Like I said, very little visibility going forward. But so far, I think it's actually on average still performing relatively well. As you can see, relatively speaking, a strong demand in the quarter with an organic sales growth, I think. So, I think that's also a positive, being humble to the fact that we don't know the future. Yeah.

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

Q

Appreciate that. And when you look at that confidence indicator and compare it to the numbers you are giving us on RTM basis, do they reflect each other pretty well?

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

Well, we – I might jump in here. I knew that once we started to show this confidence indicator, we would start to get questions on it as well. And it is an internal – it's an internal tool we have, which is very useful, I can tell you. And that is also partially forward looking. And I realize that you're curious about it, but I don't think that we're – that we can comment on what we see there.

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

Q

Okay. I'll stop with that. Thank you very much. Worth trying anyway.

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

A

Thank you.

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

Q

Good luck out there.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

Thanks.

Operator: Thank you. Your next question comes from Eric Salz from JPMorgan. Please go ahead.

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

A

Good morning, Erik.

Erik Salz
Analyst, JPMorgan Securities Plc

Q

Yes. Thank you. Good morning, Daniel and Lena. Thanks for the representation. I think most of the questions have been answered so far. So, it's good, but maybe a couple left. First of all, at the CMD, you mentioned organizational changes. And I was wondering, is that now all behind? Is it all done? [indiscernible] (00:52:56) been informed of the, I think, [indiscernible] (00:52:59) that are moving. And the other question is around the letter of intents that are signed. Is that mainly in Sweden or also international?

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

A

Good question or good questions. First, when it comes to the organizational change, everybody who – who's involved basically have been informed. And these changes have more or less been implemented already. Even though, as I mentioned, some of the persons affected will continue to work for some time before they leave or get salaries, at least for a period further going forward. But all in all, I think these have been implemented.

If we're looking at the LOIs, I don't really want to comment on the individual LOIs. I think they are, in nature, more of an add-on to existing companies to that nature. And I think – and to the extent that we have existing business units, I think we have an overweight in Sweden. So, I think that's probably the indication I could give on that one, when it comes to the LOIs and preferred – where we have the preferred buyers, so to say.

Erik Salz Q
Analyst, JPMorgan Securities Plc

Okay.

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

Yeah.

Erik Salz Q
Analyst, JPMorgan Securities Plc

All good. Thank you. Thanks very much.

Lena Paulina Glader A
Chief Financial Officer, Storskogen Group AB

Thank you.

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

Thank you.

Lena Paulina Glader A
Chief Financial Officer, Storskogen Group AB

There might still be time for one last question, but then we're approaching the one hour here.

Operator: Thank you. There are no further questions at this time. Please go ahead, speakers.

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

Perfect. So, thank you very much for listening in. And hopefully, we have given you some answers to your questions and some information on our third quarter. And of course, if you have any more questions, don't hesitate to give us a call. And for some of you investors, we will probably meet you during the day potentially. So, have a wonderful day and take care. Bye.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

Bye.