Corrected Transcript

07-Nov-2023

Storskogen Group AB (STOR.SE)

Q3 2023 Earnings Call

CORPORATE PARTICIPANTS

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

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

OTHER PARTICIPANTS

Carl Ragnerstam
Analyst, Nordea Bank ABP

Johan Dahl
Analyst, Danske Bank A/S (Sweden)

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

MANAGEMENT DISCUSSION SECTION

Unverified Participant

Welcome to the Storskogen Q3 presentation for 2023. [Operator Instructions] Now, I will hand the conference over to the CEO, Daniel Kaplan and CFO, Lena Glader. Please begin your meeting.

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

Hi and welcome to Storskogen presentation of our third quarter report. My name is Daniel Kaplan. I'm the CEO and Co-founder. And together with me presenting today is Lena Glader, CFO.

So, welcome. Let's turn to the first page, diving directly into Q3 highlights. In short, it was a business as usual quarter, in line with our expectations. We focused on cash flows and I think we saw some good results from that. Sales, SEK 8.3 billion. Organic net sales growth, minus 2%, with an adjusted EBITA of SEK 726 million. As organic EBITA growth of minus 9% and the EBITA margin 8.7%, slightly below last year. Year to date, however, margin wise, we're at 9.4%, still better than last year.

So, looking at some key events and figures, we could see that we had significant cash flow from operating activities of SEK 584 million as compared to SEK 204 million last year. A significant improvement, of course, and all our hard work delivering strong cash flows. This means, of course, that year to date, we have the [ph] SEK 1.3 billion (00:01:56) in cash flow from operating activities. And this is, of course, due to – partly due to the strong cash conversion. We, of course, communicate a target of 70%. We're currently at the last 12 months at 95%. So, gradually, well, producing some strong cash flows. Interest-bearing debt, we reduced that with almost SEK 900 million in the quarter, and the interest-bearing net debt with a SEK 190 million. We did five divestments and two add-on acquisitions. So, those were the key events in the period.

Moving on to a little bit deeper into net sales and EBITA. As you can see, sales, quite decent, more or less on par with previous years despite the fact that we have done some divestments. The margin, however, in the quarter has been decreased, primarily driven by trade. As you know, we have headwinds both with regard to currency effects, but also simply weak demand. To some extent, we could see that as well coming in from services affecting margin as well. And we have a slow July, but a much better August and September. Looking ahead, I think we're looking forward towards a seasonally strong Q4. As you might know, Q1 and Q3 are weaker quarters and Q2 and Q4 are stronger quarters in our seasonality.

So, moving on to next page. Every quarter, we will try to do one deep dive into some business aspect for relevant reasons. We're looking at cash conversion this quarter, the business insight section. So looking at last year, this time after Q2 2022, we had like a 32% cash conversion, the last 12 months there, rolling. And as you can see, we have gradually increased that as we have increased our focus on our various activity programs have come into effect, and currently at 95%. In the long term, of course, we think that we will gravitate back towards 70%, which is our long-term healthy target.

But that said, I think there's lots more to do within the reducing net working capital going forward because we're – even though we have been quite successful, we're still not really there yet. Q3 as a rule, is a quarter where we build up net working capital to be able to sell goods in the fourth quarter. And that's the seasonality from a cash flow perspective, [indiscernible] (00:05:10) so we're expecting strong cash flows in Q4. [indiscernible] (00:05:13) still not reaching our internal targets. So, we have a lot more to do in the year to come as well to continue to drive strong cash flows.

Looking at how we do this in practice, I mean, it's – in theory, it's not rocket science. In practice, it's hard work and some rocket science as well. It's inventory reduction, accounts payable improvements and proactive accounts receivable work. And we do this, of course, setting up – on an overall level, we're setting incentives and KPIs, where we measure and drive these behaviors to do this. More specifically, looking at, for example, inventory reduction within trade, that means categorizing your inventory, setting targets, following up, of course, understanding the service levels appreciated by customers so that you don't have things in stock that you don't need to have, basically.

Another part is, of course, the fact that we have reduced supply chain disruptions, which enables us to – well, I think we're far off from the previous just-in-time methodology that you could previously use. Still not functioning as well, but still better and better. So, you can be tighter and tighter in your inventory planning. When it comes to inventory reduction and when it comes to work-in-progress for industrial companies, it's all about designing the goods in the right way, understanding the supply chain as well. And of course, [indiscernible] (00:06:51) all kinds of automated tools for inventory management.

Looking at accounts payable, it's – you understand your supplier relationships, you get deeper trust, you understand when to pay and how to pay and what to pay and being stringent and disciplined. And over time, that delivers better accounts payable.

Looking at accounts receivable, especially important, I would say, in potential tough times so that you reduce losses from insolvent customers. You just have to be stringent and on your toes and being systematic in how you invoice, when you invoice, who you invoice at what time, and also your terms, of course, towards your customers. Through business intelligence dashboards and new routines, you become more efficient.

Two examples: LNS and Kranlyft. LNS, an industry producing automation equipment, peripheral automation equipment. You can see tremendous work there reducing their net working capital with SEK 138 million year-on-year, reducing working capital to net sales with a 9 percentage points. So, tremendous journey for them. Kranlyft, a significantly smaller company, but having done even more impressive work in that respect. You can see improving cash conversion tremendously. They actually already from the start had a cash conversion of 173% previously. So, they actually went up from strong levels to more than 300% this year and they released another SEK 48 million in net working capital. Kranlyft, which is a distribution company distributing mini cranes across Europe, Middle East and Africa, basically. So, hard work. Still lots of things to do here. Specially, Industry has some work to do and hopefully we will see some of our Trade companies as well delivering in the fourth quarter.

So, moving ahead and this, of course, translates into strong cash flows. And here, you can see the cash flow from operating activities the last 12 months, how it's developed, moving from SEK 1 billion in Q3 2022 to the current SEK 3.2 billion almost. Of course, even if you reduce – remove CapEx and leasing, it still leaves us with a true cash flow, free cash flow of about SEK 2 billion, which is of course a significant amount to use to reduce debt or acquire companies and in other ways create value for the shareholders.

So, how has the quarter looked like then for our different business areas? Number one is Services. If your'e looking at overall in the year, you can see a significant margin recovery. Year-to-date, 9.5% compared to 8.8% previous years. That said, in the third quarter, a relatively tough quarter affected both by companies exposed to construction or early stages of construction, and our HR and competence vertical that has also at least one company has suffered there exposed to lower – it's basically a job matching company, and of course, they have been exposed to lower unemployment and dysfunctional markets basically.

Looking at net sales, minus 8%, primarily due to divestitures. Organic net sales growth, minus 2%. Organic EBITA growth., minus 6% in the quarter. I think looking ahead, I think we can see a solid performance in the infrastructure, digital service and installation. And I think we see even looking ahead a strong Q4, seasonally stronger, and an overall solid demand across all the verticals in most companies. But of course, the challenges remain in companies exposed to new construction as well in some parts of HR and competence vertical.

So looking at Trade, this is the business area with – that have really had a tough time with weak consumer confidence. The high interest rates and the weak Swedish krona has really been tough on some of the Trade companies. Sales, SEK 2.3 billion. So, they are still actually keeping sales up, gaining market share very [ph] consistently (00:11:51). We're actually utilizing this market sentiment by being more forward looking and forward leaning. So, I think they're doing great work from a strategic perspective, and I think we would be a lot stronger on the other side of this business cycle.

The organic net sales growth, minus 3%, EBITA, SEK 188 million with an organic EBITA growth of minus 21%, of course. And this is, of course, a combination of currency headwinds and the weak demand. So, it's not particularly surprising at the bottom of the business cycle for our trade companies. However, we do see that some of the destocking we've seen in the value chains with our customers, it's improving that. So, we do see some light in the tunnel. We will see how long that the people, of course, are cautious when it comes to restocking as well. Adjusted EBITA margin, 8%. And year to date, that's 8.7% as compared to 10.3%. So, tough time for our Trade companies. Looking forward to Q4, which is a seasonally stronger quarter. The health and beauty, I should say, is, of course, the star of the Trade business area at the moment, very resilient and strong performance.

Okay. Industry. While industry is doing quite well, it's – they've had a fantastic year and a half, you might say, and demand is normalizing, but it's still quite decent, decent order books, but of course, decreasing from these high levels. Net sales, SEK 3.4 billion. The organic net sales growth of 0%. EBITA, SEK 353 million with a minus 1% organic EBITA growth. So, still quite decent, I would say. The margin's somewhat lower in the quarter, but still ahead of last year, year-to-date. Products, performing well. Margins expanding. And I think the underlying trends of reshoring, green transition and demand for automation continues to be supportive. And of course, some of the big projects in the north of Sweden really support our industry and some of our services companies as well, giving us significant orders and providing demand. So, that's on industry.

Looking at transactions, we have done a few strategic divestments. We are, of course, reviewing our portfolio to sell off low performers and companies that we don't really believe are part of our long-term future for various reasons. We're doing some few selective add-on acquisitions and acquisitions. Looking at the right column here, you can see that we have sold off companies for SEK 1.85 million in sales or it's rather SEK 1.85 billion in sales. And you can see that that's a minus or approximately 4% margin on the divested companies, whereas the companies we have acquired with SEK 583 million in annual sales have about 20% EBITA margin.

So, you can see some of our strategic intention here of gradually shifting the portfolio to the financial trades that we want to see with regard to margins and long-term growth. And of course, one of the effects of this is, of course, that we free up capital to reduce leverage, but it's actually not the primary objective with the divestitures.

So, back on the transactions, Lena.

Lena Paulina Glader

Chief Financial Officer, Storskogen Group AB

Thank you, Daniel. So, the following page here, we have the financial summary for the third quarter. Let's have a closer look at the numbers. Net sales growth was, as Daniel said, minus 1%, which is impacted by an organic growth in the quarter of around minus 2%. Divested companies, affecting another minus 3%, whereas acquisitions contributed 1%, and currency translation contributed plus 3% to sales growth.

Cost of goods sold as a percent of sales is fairly unchanged, as you see here. And so, it's selling and admin or SG&A expenses also unchanged as a percent of sales, which means that it is other operating income and expenses that explain the lower EBIT as well as items affecting comparability, of course. I will come back to that on the next slide.

We have an increase in net financial items, largely due, of course, to the higher base rates compared to a year ago since our interest-bearing debt in absolute terms has been reduced by SEK 2.5 billion from Q3 last year. In the net financial items, we also have currency effects that stand for SEK 73 million increase, where interest costs are SEK 121 million higher compared to the previous – to the quarter last year. Return on equity was 6.1%, obviously, also impacted by the higher financial costs. Return on capital employed was 8.6%. Net of goodwill, return on capital employed was 19.3%. So in other words, the return of the underlying businesses is still around the 20% mark.

Earnings per share was SEK 0.09 before and SEK 0.08 after dilution. Although this is twice as high as in the second quarter, it is notably affected by the net financial items leading to a year-on-year decrease. We'll have a closer look at the earnings bridge here on the following page. Still sticking to the third quarter, we tried to illustrate here what items affect the underlying profit in the third quarter versus the third quarter last year, obviously, here shown as profit before tax or PBT.

If we disregard non-operational items affecting comparability, FX items and other non-operational items in the financial net – these are the light gray bars here – the comparable profit before tax was SEK 443 million in Q3 last year and SEK 230 million in Q3 this year, based on the two dark blue bars on this chart. Reported earnings were, in other words, favorably impacted. Reported earnings were favorably impacted by non-recurring items last year but adversely impacted by non-recurring items this year. Gross profit held up well, as I said previously, despite the inflationary environment and so did sales and admin expenses being flat, approximately flat year-on-year.

So, what did affect profits, seeing the gross profit and sales and admin expenses were pretty much in line? Well, first, we have SEK 62 million explained by lower other income in Q3 this year compared to Q3 last year. And the vast majority of this SEK 62 million is due to that – the third quarter last year had large revenue, fairly large revenue from third party relating to a company which was divested earlier this year. So, this revenue is not included in Q3 2023.

Second, net interest expenses have increased, of course, as mentioned earlier, due to significantly higher market risks. The STIBOR is up by more than 3 percentage points compared to Q3 last year, and of course, higher coupon on the recently refinanced bond that we did in June this year. We've now, however, hedged around a quarter of our loans to fixed rates in order to stabilize this somewhat. But given that rates may be higher for longer, further reducing the absolute debt level will, as you understand, continue to be a top priority.

That was about the third quarter. Now, let's have a look at the year-to-date financials on this page. Year to date net sales growth was at plus 11% to SEK 27 billion, impacted by organic growth of minus 2% in the year-to-date period. Divestments affecting growth by minus 1%, acquisitions contributing plus 11%, and currency translation contributing another [ph] plus 3% (00:21:23).

When it comes to cost of goods sold and SG&A expenses, the same goes for the nine-month period as for the isolated third quarter discussed previously. These costs are kept fairly stable or actually somewhat lower as a percent of sales during the year-to-date period. Profit before tax was SEK 1,077 million for the period, a decrease of 32% due to the higher base rates affecting net financials again. Earnings per share for the nine-month period was SEK 0.40 compared to SEK 0.64 for the same period last year.

And over to the cash flow statement for the third quarter. Our focus on cash flow is yielding significant response as shown on this page. Cash flow from operating activities after interest and tax was SEK 584 million in the third quarter, which is a year-on-year increase of SEK 380 million. Change in working capital contributed minus SEK 6 million, so pretty flat in a quarter when we normally would build inventories. Reduced inventories and increased in payables are items contributing slightly positively to cash flow or to operating capital, while increased receivables contributed slightly negatively, but no large amounts here.

Cash effects from M&A [ph] related (00:23:07) activities, including earn-outs and minority payments, was plus SEK 65 million for the third quarter. And this SEK 65 million consists of proceeds from divestments of SEK 454 million. This includes a partial payment related to the Dextry divestment in the second quarter as well as the divestments that were actually completed in the third quarter, of course, and paid earn-outs and minority purchases of SEK 389 million in the third quarter. Earn-outs will be substantially lower going forward, but we expect to continue to buy back minorities also in Q4 and next year. But please note that having smaller minorities actually impacts the earnings per share positively.

Given that we've paid down some loans substantially during Q3 using cash flow and cash at bank, the total cash balance was reduced to SEK 1.4 billion. But total available liquidity is still high at SEK 8.2 billion if we include unutilized credit facilities. Cash conversion, as Daniel mentioned before, strong at 85% in Q3 and 95% for this LTM period.

And let's have a closer look at the cash flow bridge here. On this page, we illustrate our cash flows for the last 12-month period. Please note that the previous page is related to Q3 only. Cash flow from operating activities was

SEK 3.2 billion, as Daniel said before, during the LTM period of this. I'm sorry, CapEx was SEK 637 million, approximately 1.7% of sales, which is a normal state. And IFRS leasing, which is, of course, not defined as operating according to IFRS, but in reality it is pretty operational. That was SEK 557 million, [ph] 1.5% (00:25:12) of sales. So, that means that free cash flow after leasing was SEK 2 billion, as Daniel mentioned, for the last 12 months, which is a year-on-year increase of SEK 2 billion.

M&A activities, including minorities, amounted to a total of minus SEK 70 million for the last 12-month period, and earn-out payments related to previous year's acquisitions were SEK 633 million during this 12-month period, but will, as I said earlier, be lower going forward. This means that cash flow before dividends and change in loans amounted to SEK 1.3 billion for this period.

Over to the next page, we illustrate cash conversion, which is pretty much the same as Daniel showed on his same slide there with a group target of 70% marked as the dotted line on this page. The rolling 12-month cash conversion has, of course, improved every quarter now from Q2 last year, thanks to good work by our subsidiaries in reducing inventories and receivables.

And over the last 12-month period, working capital has been reduced by SEK 412 million, not including effects from divestments. Lower inventories and receivables contributed by SEK 570 million to this, whereas payables are also somewhat lower, which affects cash flow negatively by around minus SEK 160 million. But the work is by no means finished. We believe that there will still be further positive effects in the coming quarter.

And then, a look at the balance sheet on the following page. Here, we show Storskogen Group's condensed balance sheet for the end of Q3 2023, the end of Q3 2022, the end of last year, and the change from the end of last year. Our total balance sheet is 3% lighter year-to-date, and this is largely due to divestments as well as working capital focus, which has enabled us to lower our debt and strengthen our balance sheet. Seeing here also that equity has increased by 5% year-to-date, while debt and net debt have been reduced substantially, both interest bearing and non-interest bearing. And I will show this closer at the next page where we have total debt and leverage.

Development since Q3 quarter-on-quarter since Q3 last year is what you see here on this page. So, compared to a year ago, interest-bearing debt is SEK 2.5 billion lower, while contingent consideration, meaning earn-outs and minority liabilities, are SEK 650 million lower year-on-year. Compared to last quarter, so Q2, interest-bearing debt is SEK 900 million lower, while contingent considerations are SEK 375 million lower. We have used our cash flows as shown on the previous page, this was SEK 1.3 billion as well as cash at bank to do this.

We had significant cash and cash equivalents at the end of Q3 still, totaling SEK 1.6 billion, which, in addition to cash at bank of SEK 1.4 billion, this also includes derivative instruments as well as cash in transit that related to divestments at the very end of Q3 that were paid at the very beginning of Q4. And these two total SEK 210 million. We will continue to use existing cash and expected good cash flow in the fourth quarter to further reduce debt. However, due to negative organic profit growth during the period, as Daniel showed, the reduction in net debt was not enough to bring leverage down. Interest-bearing net debt to EBITDA was, in other words, still at 2.6 times at the end of the quarter. Nonetheless, our ambition remains to reduce not only gross and net debt, but also to reduce the leverage going forward.

That was it for me. Over to you again, Daniel.

Daniel Samuel Kaplan

Co-Founder & Chief Executive Officer, Storskogen Group AB

Thank you, Lena. So in conclusion, I think we're still working hard on our strategic priorities. The primary one is, of course, to generate strong cash flows so that we can reduce leverage over time. I think we're seeing some great progress there, even though we're not finished yet. I think we have lots more to do there. We have done some – we're continuing our strategic review. We've done a few divestments in the quarter. And of course, in these challenging times from a macro perspective, we're focusing on margin and we're actually quite happy in the business unit level with our ability to gain market share and position ourselves strongly going forward. Looking ahead in Q4, we know we're looking forward to a seasonally stronger quarter, of course, both from sales and cash flow perspective.

So, thank you very much, and let's get into questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] The next question comes from Carl Ragnerstam from Nordea. Please go ahead.

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

A

Hi, Carl.

Carl Ragnerstam
Analyst, Nordea Bank ABP

Q

Hi. Good morning. It's Carl here from Nordea. A few questions. Firstly, looking into cash flows, inevitably quite good in the quarter. But as you said, debt or leverage remains sequentially unchanged, of course, due to contingent consideration option payments. Could you remind us whether you will have any significant payouts coming here in Q4 and Q1 related to contingent considerations or minority auctions? And are you still as convinced as you were in Q2 that you'll sort of reach the lower end of your leverage target at year end here?

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

Well, I can – hi there, Carl. I can answer the first question. There will be -let's see now – a minority liability payment or purchase rather of I think around SEK 100 million to be expected for Q4. A small amount in Q1, typically, and then we would have some earn-out payments due in Q2 if everything goes well, which means that the underlying companies are performing as planned in the second quarter. So, smaller amounts, but there will still be some earn-out payments in the second quarter likely.

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

A

Yeah. And coming back to your second question, we do feel confident that we will generate strong cash flows in the fourth quarter, positioning us in a good way to reduce leverage. If we will reach the lower end of the spectrum, I think that's remains to be seen. It certainly is more sticky than we had anticipated on the leverage, but I think we were expecting some headway in Q4. But it is, of course, a challenge to reach the lower end. But we don't know yet. That remains to be seen.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB
A

I will correct my previous answer and say that we also expect some earn-out payments or minority payments in the first quarter as well, even though we typically don't do it. And I believe that we would have some smaller amounts paid also in Q1.

Carl Ragnerstam
Analyst, Nordea Bank ABP
Q

Are we [ph] talking a (00:33:39) couple of tens of million SEK? Or what's smaller amount, is it in that range, I guess, or?

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB
A

I think it's more than SEK 100 million.

Carl Ragnerstam
Analyst, Nordea Bank ABP
Q

Okay.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB
A

Yeah. But then again, bear in mind that, as I said before, buying back minorities would also be positive for EPS since we would own a larger part of the net profit [ph] of the group (00:34:00).

Carl Ragnerstam
Analyst, Nordea Bank ABP
Q

For sure. Okay. Very good. And also, I mean, on leverage here in terms of capital allocation, you on one hand want to reduce leverage, but you also continue to do some acquisitions and some divestitures, of course. But how should we look at capital allocation going forward? So, if you look at your, for instance, free cash flow next 12 months and what portion with the visibility you have today will be allocated towards acquisitions? And also on that note, do you have any LOIs currently either from acquisitions or divestitures?

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

So, coming back to your question, I think looking at this year, we have done two types of acquisitions. One has been platform acquisitions, which has been two. And the rest have been add-on acquisitions. The platform acquisitions have actually contributed to lowering our leverage. This accounts for both those transactions. So, those have had a positive effect on the leverage. If you're talking about Physics Café and AC Electrical. Those that have actually had a negative effect on leverage is – as the – is the add-on acquisitions. And of course, on each individual add-on acquisition has been very small, but on aggregate they have basically compounded into affecting our leverage somewhat. That said, they are enabling our portfolio companies to obtain stronger market positions and increase profitability over time as well. So of course, they are of a strategic nature as such.

Going forward, I think we will be – given the fact that it has proven to be [indiscernible] (00:35:41) reduced leverage than we anticipated, partly due to the negative organic EBITA growth, I think we will be even more restrictive going forward when it comes to acquisitions. I mean, during the Capital Markets Day, we basically communicated that we were going to reduce M&A pace, not that we would hold it. I think we will be very restricted going forward. So more or less, with the exception of some very small add-on acquisitions maybe, which is more or less related to CapEx or something like that, you can mention that, I think we will really focus cash flow here to reduce leverage as our primary objective.

Carl Ragnerstam
Analyst, Nordea Bank ABP

Q

And do you have any ongoing divestitures here or are you done with the sort of low-hanging fruits with the installation companies, for instance, and also the [ph] painting (00:36:36) companies?

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

A

I think we will continuously, regardless of business cycle, always review our portfolio and looking at divesting both low performers and companies most aligned with our long-term strategy, so to say. So, there will always basically be discussions with regard to that. I think that said, one should anticipate that the market, the M&A market at the moment is relatively slow. I think the multiples are more or less the same actually for these companies, but a lot fewer buyers and a lot fewer companies for sale as well, both on the demand and the supply side. So, any type of process takes longer, to put it like that.

So, it will be a continuous process, looking at the divestitures. However, I think we really – we always get bids on some of our companies continuously because we are in lots of different sectors and geographies. So, we always have companies that are of industrial interest to various types of buyers. However, we have decided, basically we feel very comfortable in our cash flow generation. So, we are avoiding, if you will, fire sales or selling off companies previously. But we stick to selling companies that we don't really think fit the portfolio long term. So, I think sacrificing a few fast deals and basically doing the deals both on divestitures and acquisitions that we really, really want to do. But of course, the next year will be more related to divestitures. But if that might answer it.

Carl Ragnerstam
Analyst, Nordea Bank ABP

Q

No, it's very clear.

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

A

Yeah.

Carl Ragnerstam
Analyst, Nordea Bank ABP

Q

And the final one from my side is a bit on pricing. We saw obviously raw materials coming down, logistics cost as well. So, could you perhaps shed some light on how you work with pricing currently? Should we expect you to have pricing power enough to to keep up your prices and probably benefit from various costs coming down? Or should we see a bit of deflation in your numbers? Or do we actually see it currently here in the organic sales growth?

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

A

I think we don't see a general trend of costs coming down. I think we do have – even though I would say the entire inflationary circle, so to say, is certainly grinding to a halt. I think that's been, as you can see in the macro. But it's – individual costs for individual items can, of course, Services can, of course, decrease. I think we have a decent pricing power. I think we have managed to push on price increases to a large extent to customers. That said, for example, within Trade, when volumes go down and you have fixed costs, even if you have decent margin upticks, it still results in the total margin going down.

So, I think it is, of course, always a struggle to keep the margins up when demand is relatively weak for those companies that have [ph] suffered that (00:39:58). But I mean, for us, diversified portfolio, in Services, most of our companies are performing quite well. In Industry, it's more normalized, demand situation, still performing, most of the companies performing well. So, I think we will be seeing a decent margin development. But of course, it's – depends a little bit on the demand situation for next year.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

I might add to that as well when speaking of margins and protecting margins, that Trade, business area Trade still have quite substantial negative impact on margins from the stronger dollar against the Swedish krona – or the weaker Swedish krona rather in the third quarter. We said, I believe, in Q2 that this was approximately one percentage point on the EBITA margin. In Q3 slightly less, but still 0.7% or something like that percentage point actually of the Trade margin is [ph] accretive (00:41:05). So, had the SEK been stable compared to last year, then margins would have been 0.7 percentage points higher.

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

A

I should say it's not only about price, it's also about cost. I think we are – for example, within Trade we have conducted significant cost reduction programs in a number of our companies that will come into play gradually during the next year. Hopefully, contribute to some margin protection there. And I think we have contingency plan in every company depending on how they develop, to keep costs tight in this environment.

Carl Ragnerstam
Analyst, Nordea Bank ABP

Q

Very clear. Thank you so much.

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

A

Thank you, Carl.

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

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

A

Hi, Johan.

Johan Dahl
Analyst, Danske Bank A/S (Sweden)

Q

Yeah. Good morning, everyone. Just two quick questions. You talked about, Daniel, a bit more [ph] sticky (00:42:13) debt perhaps than you had anticipated in the beginning of the year. Obviously, underlying earnings impact your ability to reduce that. But just focusing on working capital, are you able to see any sort of structural improvements in the group? And looking in the rearview mirror also, if you could put into sort of in the coming one, two years, what are your ambitions, your updated ambitions in terms of structurally reducing working capital as a percentage of sales?

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

I mean, very good question on that. If we come into the net working capital question, I think we have seen some significant progress in our companies and also with ourselves in how we introduce KPIs and incentives into the companies and work hard on educating the companies on how to improve. And I think we can see those improvements. That said, we have the internal targets that basically were higher than we have achieved so far. I think Q4 – normally, I mean, Q3 is a time where you build inventories so that you can sell items in this fourth quarter.

But – so, I think we will make some additional headway in the fourth quarter. But that said, not all the way. So, we haven't really produced new targets for next year. I think that's a part of our budget process actually. But I think coming back, I think there are some significant work that remains to be done when it comes to cash flow or net working capital for next year.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB
A

Can I add to that? Thanks. Just a quick reminder, the companies that we've sold so far this year are pretty much within the installation business. And in Services, that tie up a lot less working capital typically than Trade and Industry. So this, of course, skews the whole net working capital to sales a bit, given that these companies also did have quite high turnover, that is – and relatively low working capital. Sorry.

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

But I think when we've defined and set the bottom-up targets for each and every business unit, I think we can see what we will have for internal target on net working capital for next year. But I think we know for sure that there are some things to do here, especially within Industry to be transparent. I think they have – could do more when it comes to releasing net working capital.

Johan Dahl
Analyst, Danske Bank A/S (Sweden)
Q

All right. I heard, Lena, you talked about hedging interest rates, a quarter of the portfolio. Was that right? What is your strategy here going forward for your debt portfolio and the duration approximately for those hedges?

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB
A

Yeah. The strategy for the debt portfolio is to reduce it and to reduce interest costs gradually going forward. One way to do this is, obviously, the large work has been – we put in – we've done a great work in reducing the absolute debt. I mean, that's the most important, SEK 2.5 billion. And interest bearing is lower compared to a year ago. Also, trying to stabilize the interest rates by fixing now, as I said, a quarter of the loans to between three and five years rates, which would reduce it somewhat going forward. We are looking at now, I guess, the rates have come down a little bit more in the past week.

So, we are looking at doing some further transactions actually in the Q4, during Q4 and – yeah. But then, the strategy is, as I believe Daniel mentioned also, is to even out the maturities to have a longer average debt maturity profile. It's now around, I think, 26 months. But we are gradually paying down the shorter-term debt and now we issued a longer-term bond in June, which also impacts that. So yeah, we're working on all fronts here, both interest rates and absolute numbers and maturity.

Johan Dahl
Analyst, Danske Bank A/S (Sweden)
Q

Thanks.

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

Thank you, Johan.

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

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

Yes. Good morning, Daniel and Lena. Good move on the free cash flow. And just want to pick your brain on the SEK 2 billion that you now report in LTM adjusting for the leasing effects. What kind of building blocks do you see for movement in that over maybe the next 12 months? Would you expect it to be a sequentially much higher number or is this a good level that you would expect to remain of?

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

What SEK 2 billion were you referring? Was it the...

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB
A

LTM [indiscernible] (00:47:56).

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

The LTM free cash flow after leasing.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB
A

Well, I can maybe start there. We're not giving any guidance on profit development for the next year. So, that would be up to your own guess or estimate what that would be. CapEx has been maintained at a very stable level the past few years, between 1.5% and 2%. Now, it's been at 1.7% this year to sales. Leasing is also really stable, a little bit lower than CapEx, 1.5% maybe to sales. So, those two you can calculate on. And then, it, of course, also has to do with the interest cost that we now said we are working towards lowering those going forward, hoping that Q3 was the peak point. We are also continuing to work on working capital, as you just said, Daniel. In Q4, we expect to see good improvement there and we will continue to work next year. So, I don't know. Those are the building blocks maybe that we can talk about.

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

A

Yeah. But I think – I mean, the cash flows, and I think we are confident that we will generate strong cash flows next year. I think that's the key, of course, for us to manage our deleveraging strategy, basically.

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

Q

But let's say like this, taking away unforeseen events and these kind of things that we might see, I guess, with the business mix you have and the revenue sides and the profitability sides, so you're talking about when you're talking about the LTM numbers and so on, it would suggest that we should see another, yeah, maybe SEK 300 million to SEK 500 million upside in that kind of cash flow numbers. That's totally unrealistic.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

I think we cannot comment on that question. I don't know what our Investor Relations says here in the room.

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

Q

Yeah. [ph] So, they are checking (00:50:01). That's fine. That's fine. So, that's fine. Lena, could you just remind me what kind of refinancing needs do you have over the next 12 months or so, please?

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

Actually, none. We've got no maturities in this year and none in 2024. We do have the next bond maturing in December 2025 and we are continuing to work on the bank loans, obviously. So, those are the ones that we are now paying down as well. So, no near-term maturities.

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

Q

Excellent. Thank you very much and all the best out there.

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

A

Thank you, Karl-Johan.

Lena Paulina Glader
Chief Financial Officer, Storskogen Group AB

A

Thanks.

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

Daniel Samuel Kaplan

Co-Founder & Chief Executive Officer, Storskogen Group AB

So, thank you for listening in today. Have a wonderful day in the great Swedish weather. And any questions, don't hesitate to give us a call. Thank you very much.

Lena Paulina Glader

Chief Financial Officer, Storskogen Group AB

Thank you.

Daniel Samuel Kaplan

Co-Founder & Chief Executive Officer, Storskogen Group AB

Bye.