6M 2022 Analyst conference call transcript COLT CZ GROUP SE

Jan Drahota, CEO:
Good morning. Today I have Jan Zajíc with me, Dennis Veilleux is not going to participate even though he is in Europe, but he is at the moment flying out of Sweden to the US so I have to excuse him. But let us go forward to the presentation. First of all, six months at glance or key KPIs for six months, revenue up by 49% to7,049 bn CZK, adjusted EBITDA In the same rate of increase of 49% and the amount of 1.795 billion CZK, net profit up by 44% at 1.183 billion CZK and adjusted EPS almost 35 CZK per share up 44% in the last six months or in the first half of the year. So, overall, the comment is that it is a record first half of the year for the group and obviously it does reflect and we will go into detail what are the main drivers of that but it shows that that we are still growing in a very healthy space. So base so if you go to the next slide.

First of all, this is more detail about a breakdown of our sales, there is geographical split and also split by unit sold. First of all, units sold you'll see that the unit sold increased slower than the revenues. So, a little bit less than 20%, 19% to 363 thous. unit sold. You see that there is a let us say faster growth of long guns compared to handguns.

And this basically reasons the faster growth of dollar revenues or CZK revenues. We are selling a higher value product. So basically, the product split is better or is more expensive. As far as the geographical growth is concerned, I would say that you will see that most of the key markets wind up in terms of their importance at the expense of US.

So, you'll see that US is, is now below 60% of our sales, so around 58% of sales. The reason is, I will say growth in other markets, but also, you know, that we have been saying for some time that we see the healthy share of US market around fifty to maximum 60%. So, we are getting closer to let's say, healthy split. The comment, or if I were to comment on one particular market as well or, or other markets as well, it's Czech Republic went up because of the Czech army deliveries, Canada, it's caused mainly by the inclusion of Canada in our consolidation in h1, Europe, very healthy market, you know, growing significantly. And Asia, same thing. Africa, you know, dramatic drop, but it is caused by one off events. So, we see potential there as well. So, this is driven by a larger transaction. So, we have not realized any larger transaction in H1.

If you go to next slide.

So, first of all KPIs revenues, I already did command at 7.049 billion CZK, 49% up and the same for EBITDA, I also did comment it. Maybe it's always interesting to see that EBITDA margin, you know, is around 25.5%. So, it's a strong EBITDA margin and it shows, it confirms once again, the better product split, and also our ability to control costs in the first half. As far as the guidance is concerned, we are confirming guidance for the EBITDA at 3 billion to 3.3 million CZK. And revenues, they are saying that currently we see the revenues at the end of the year in the range of 14 to 14.6 billion which is slightly lower than original nature 14.4 To 14.8 billion CZK.

At this slide, you'll see that there is a comment that guidance has been confirmed despite a challenging environment, I will say that my comment would be the same as in after q1 results. Obviously, we are in an environment where we see first of all shifts in demand. So, we see that the demand is moving or increasing significantly or at least the interest and potential demand is increasing significantly on the m&a side or to our professional customers. And at the same time, they are segments on US commercial market. US commercial market as a whole is a little bit weaker about what we see that there are segments of the market which are which are much weaker, and then there are segments which are really strong for us. So, it's definitely a different market than maybe 18 months ago. Nevertheless, I would say that our diversification in terms of customers, but also products, give us confidence that we are able to reach guidance and also that we are ready to capitalize those opportunities, because there are real opportunities on the market. And we see significant because even on the commercial market in certain categories of products for more brands. So, we thought we believe that there is still you know, market share to gain and money to be made.

If you go to the next slide just this is just an illustration of what I said at the beginning, you know, earnings per share almost 35 CZK in the first half of the year, which is 54% increase and and same goes for net profit. There are small adjustments you can see them in the annex of the presentation, I would say I would name the two which were the same for EBITDA first of all, there were some one off costs or costs related to advisory costs related to m&a which we excluded in most slides out and 30 million and same goes for the and also we started to implement the ESOP program in the in the H1 or Q2. So, there is a there is a cost of around 33 million related to that.

If you go to the next slide. I would say that here, what is important to comment is guidance for capex. This is another guidance that you are giving. What we see is that we will be let's say at or below 5% of revenues. Currently we are saying that it's 700 to 730 million CZK.

We now I manage the capex at the global level. So, we are really scrutinizing all the capex and the level of CZ and Colt to make sure that we have the right capacity and balance capacity also with the production capacities, which we have as a, let's say, satellite production capacities, you know, suppliers or our partners. And again, you know, the business is generating, you know, good cash flow out.

If you go to next slide. Debt structure, this is confirming, I will say that here, there is nothing, no significant change compared to the q1 of this year, the bonds are still the same. So, we are financing mainly by the bonds, you know that the interest rate exposure of those bonds is hedged in the amount which is higher than the net debt. The net debt is at 3.743 bn CZK.

It's after the payment of the dividend in H1. So, some leverage even after the dividend payment is around 1.5x EBITDA So, for us, it's, we see that we have significant room still to realize our acquisition, let's say ambitions and, we see, and yet we are still at the conservative levels in terms of endeavors.

You go to next slide, please.

In the h1 report, you will see that we signed SPA to purchase 100% shares of our minority investment in the past in Spuhr. There is more detail about Spuhr I would say it's a niche player. And so, in terms of financials, it's a small company, but we see huge potential for the business, it's because it nicely fits into our portfolio. And it fits for two reasons. Because first of all, it manufactures most advanced or most or highest rated mounting solutions or vertical mounting solutions for military, military products. So, I would say that all the special forces or all the, let's say, elite units are using, most of them, using Spuhr mounts for air optics. So, we believe that going forward, the system will be more and more important. So, it gives us an edge here. And also, and this is really important, it has great experience in upgrading certain products actually of our competition, so HK products and B five and also G 3. So, G 3 rifles. So, we see also potential, because what we are witnessing is that governments are currently around the world. And the interest to expand on defenses definitely has grown. And there are you know, there are customers who want to upgrade the fleet immediately, but there are also customers who are considering, you know, upgrading in the form of a upgrade of the current fleet. And then to do a real, let's say, consideration in terms of what road system to adopt, and also what category to adopt. So, I think this gives us a good intermediate, let's say solution for customers who are still hesitating. So, on this slide, we also have references of some of the product and our blue-chip customers.

The business is growing or is very, has been growing quite nicely in terms of revenues, but also has a good profitability, it has higher profitability than our current business, you know, significantly. So that's we believe this skill, which can be really, I would say deployed in the group and really leveraged.

If you go to the next slide.

This is a slide which is just several information not all of them are, let's say from the same category, first of all, it sums up that we paid dividend. There was record dividend for us 25 CZK per share. First of all, also in the first half or in q2 or 30th of May, we released around 330,000 shares as a part of the earnout to Colt shareholders who sold us Colt. Also, we already discussed that we started to implement ESOP for the employees, and you'll see that there was around 1/3 of ESOP implemented in the six months of the year in Q2 of the year. And last information is a bit different but I think that this also gives you more info which I believe that you will be asking about energy costs. I will say that for us energy costs and you know that is definitely that's a bigger focus in Europe than in the US. So, we give here a bit of granularity on CZUB, because and you'll see that the cost went up significantly over the last two years, it has been very fast, you'll see that in 2021. The costs for energy, which is gas and electricity were around 70 million, this year, we expect 240 next year 450. It once again shows that the let's say the output, let's say the profitability of the business is very strong, the business is robust, because even though the costs are higher, significantly year on year, we are showing healthy growth in EBITDA or operational profitability. And this was the last slide.

Klára Šípová:
Ladies and gentlemen, if you have any questions, please raise your hand in the team's application or speak directly to the microphone, you can unmute yourself.

And the first question comes from Atinc Ozkan from Wood&Co. Please go ahead.

Atinc Ozkan:
Good morning. All thanks for the presentation. I have a couple of questions, but I'll limit them to two for the moment being. The first one is if you could provide some update regarding your efforts to start producing CZUB design products in the US at Colt facilities. How is that progressing? If you could provide us any maybe key targets or any recent achievements?

My second question is regarding something I've been observing in the general defense aerospace industry. In the last couple of weeks, I've seen defense contractors, flagging supply chain disruptions, components shortages, I know you are basically firearms producer, but is this a risk for your company? In the current environment? Thank you.

Jan Zajíc:
Okay, coming to the first question, as you said, whatever the production CU in the US and you might already heard several times from Jan, whatever the goal is, I'm going to have two very flexible production units, I mean, being able to produce CZ products in the US or Colt products in UB. So currently actually working both activities, I mean, to bring in the parts and the products to be new, we have on the table a couple of key components from Colt, for example, 1911. And going to the other direction, that's a little bit related also to our manufacturing, or assembly and manufacturing in Kansas which we just now moving or actually already moved to the West Hartford facility.

And we are getting first results and first products right now. It's already happening for example, scorpions or a duty pistol. So, the project is running, it's very successfully running and, and the ultimate goal, as I said, is to have very flexible to productions for all products.

Jan Drahota:

Thank you. Maybe to add to that, is that as I said, our ambition is to have to, let's say production hubs which are able to switch production between them according to the demand according to the costs. That's the first thing, the second thing, we are also working quite intensively on r&d cooperation. So, when we are talking about new products, we are definitely always thinking whether it makes sense to have the two products for more brands or not. So, you will see first results in next year. And I think that this is really intensive cooperation between CZUB and Colt, to make sure that we deliver on those. As as far as supply chain is concerned, obviously, I would say that we have advantage or advantage that we have a self-sufficient capacity here. Even though we have suppliers. It's not that we don't have any suppliers. But I would say we don't see real structural problems in our supply chains, either in the US or in the Czech Republic. Obviously, you cannot exclude anything, but I will say that we learned a lot during the COVID times.

So, we were able to stock up a bit of materials, you know, in order to face it. And also, we have worked quite significantly on cooperation between two brands to combine the supply chains. So, there is an ongoing discussion and efforts by both Colt and CZ guys to make sure that the purchasing managers in each company are cooperating and maybe using their supply chains, you know, took advantage of the other company. So, this is what's happening. Yes, the risk is always there. But I will say that we don't see currently and a big hurdle to be able to deliver, to deliver to our customers, more hurdles will be always on our side to be able to flex, let's say to change production according to market requirements, you know, the production makes the ability of our suppliers.

Atinc Ozkan:
Perfect, thank you.

Klára Šípová
Thank you. And the next question comes from Peter Bartek, from Česká spořitelna. Peter, please go ahead.

Petr Bartek:
Good morning. Thank you for taking my questions. First, when I look at your guidance for the full year? The second half outlook looks slightly ambitious in terms of sales compared to the especially second quarter, there was a slowdown in the US as far as I already did. So, if you can elaborate on the origins, from what sources the healthy growth should come?

Where do you see chance to enter new governmental markets in the EU, specifically Germany? If you already have some results in Germany? Maybe also Hungary? What is the production in Hungary? How does it look like?

So that so that will be first question and second. The EBITDA margin guidance for second half is about 19%, or 16-22%. Basically, quite lower than in the first half. So, is it a level this 19% something we should expect, say in the next year or in the midterm? Or what do you think about it?

Jan Drahota:
First of all, answer to your first question about regional sales, I will say that, it will be big simplification to say that the US market is weak as such, there are segments which are really strong and where we struggle to supply the back orders, which we have and that are definitely segments which are weaker, especially the MSR segment, or the polymer frame pistol segments. So that's what I will say today. So, if I look at our position on that, we believe that in our markets globally, both military and law enforcement also commercial where we can supply our products. So, we when we give the guidance, we gave it with the full, let's say, understanding of the current situation and with confidence that we can reach it. We wouldn't give it otherwise. As far as individual European markets are concerned. We don't comment on individual contracts. But I will say that there are, you know, this year, there are no big contracts, you know, being awarded in Germany, we're asking specifically in Germany, but we are definitely working or our teams, our German team is working on opportunities, which are there and which are to be there. So that's coming to Germany.

As far as the second question was related to, to the EBITDA margin in H2, I don't know how you calculated it. Yes, I don't know how you calculate it for us. We don't expect the EBITDA margin to go down dramatically. At the same time, we know that there are holidays, they are you know, company holidays at the end of the year, so. So please look at the guidance and going forward, maybe command to that, we are not giving definitely guidance for 2023 and beyond. But our ambition is to grow. Our ambition is to let's say to keep profitability. We always repeat that we believe that profitability in terms of EBITDA above 20% is what is needed in our industry to be able to invest to machines, to r&d and people. So, we don't plan to go down with profitability. So that's, the best answer I can give you. And we will take the measures in terms of cost, but most importantly, in terms of products to be able to reach, because it's about, it's about competitive products and competitive costs as well.

Pavel Ryska J&T Bank:
I also have two or three questions. So, Mr. Drahota, in your initial comments, you mentioned shifts in demand. Could you provide us with more color on that? What exactly that means, if it is that inside the commercial market, there are big shifts in demand, and you might be struggling sometimes to adjust to them or if it is in the in the public market? My second question concerns the net debt to EBITDA so now you have something around to 1.5. And if you are going to complete the acquisition of Spuhr and Dalhby, where do you expect your indebtedness to stand and concerning for the acquisitions? What kind of acquisitions that could be if you can comment already. And finally, if you have any comments on the payout ratio and the dividend policies, so for the last year, you paid quite a high dividend, which was a nice surprise, and if you could maybe give us an idea of where the payout ratio might stand for this year's profit. Thank you.

Jan Drahota:
Yes, okay. Thank you. So, shifting demand. Yes, definitely. You know, if you look at the global market, what we see is now that there is definitely, you know, growing interest, which is materializing demand on the MLE side, that's for sure. So, we see a bubble, let's say government to come back to the market governments to come back to the market, which was also levels, let's say, I would say delay caused by the COVID. So, there are two things, you know, lower spending and COVID. And we see that the governments are coming back, can we see the guys are busy, basically, the lead time that is slower, it takes more time or longer lead time, but we see quite attractive conditions that about it's always about executing at the end of the day, as far as commercial market is concerned, I will say the only comment I will have to shift in demand is the US commercial market. So, we see is that the most competitive segments and for me the most competitive there are the segments, which grew most during the COVID time, which was the polymer frame pistols and let's say you know, the MSR type of products, the demand has shifted substantially and then there are segments which are really healthy, and where we see really good pipeline and really good back orders. So, so, so, obviously, being a production company, it takes you know, for us, three to five months to adjust to the demand shift and so, so, that basically we are already adjusted, I would say and we took you know, necessary measures to first of all to be able to satisfy demand for in the segments where the demand is really strong, because we see substantial back orders in certain categories, which we see that it we will have difficulty still to justify or satisfy them next year. So, that's basically it. As far as net debt to EBITDA after Spuhr acquisition, you know, the multiple at which the SPV is assigned together with the earn out is, I would say, lower than our multiple so net debt to EBITDA should go to. So, it will I will say microscopic, I am done the calculation but it can be 1.7 times or 1.8 times. So, it's something which, is microscopic. And obviously it evolves in time because we are generating cash flow. So, I would say that this is not material to the net debt to EBITDA parameter. These are all questions?

Jan Ryska:
It was the dividend payout ratio.

Jan Drahota:
Yes, dividend payout, we had a discussion about it on the on the board. And as we are now in the process of planning, the 2023 and beyond. And we have a meeting where we would like to, let's say approved, together with the supervisory board, we would like to where we will formalize the dividend policy in three weeks, but I will say that our ambition is still to reward shareholders for their participation. So, you know, last year looked surprising because there are many extraordinary items in the net profit, so it even increases the payout, you know, particularly to levels which high this year, reflecting the high profitability of the business. Yes, I don't have a figure now. Sorry for that, but we will behave we plan to behave in the same logic

as we did last year. So whatever reward our shareholders for participating in the business, so figure I don't have, but I will say that when we have a minimum of 33% of the of the net profit to be distributed, I think that will be hovering around 50%. You know, but you haven't officially approved the dividend policy yet.

Klára Šípová:
Thank you. And I saw that FIO banka was asking, Mr. Raschka, would you like to go ahead with your questions?

Jan Raška:
I had a question about dividend policy you answered now. So, I have maybe one question. What about your acquisition position? Once again, which segments do you target? Are you looking for firms with a strong specialization on a military segment or army segment or, or firms that supply also to commercial segment, if you can more specify, again, thank you.

Jan Drahota:
You know, our acquisition targets or let's say the general description hasn't changed. So, it's things which are connected with us with our industry. So would be ammunition would be optics, optoelectronics you know, if I were to give you more granularity we are working really hard on you know let's say add things or competencies which makes sense for us how we see the business is that we believe that we have very strong, two very strong brands for the commercial market and they have not yet saturated their market position. So if you asked me whether we want to add additional brands for commercial market, it would have to be super attractive because I believe that both Colt and CZ still can grow substantially in the US because you know, today we have single digit market share and knowing that Colt is selling only two products to the market with our two plus one products so it's selling on the you know, handful of MSRs but also and then it's selling revolvers 1911, we believe that we can really widen the portfolio and same goes for CZ. So, we can our ambition is to grow market share or for the two brands, the commercial market and we don't see now attractive target for the commercial market firearms. So, we don't think that there are you know, brands which are super attractive to us for specific reasons.

So, we believe that we can grow organically by the two brands, if we add more products which are attractive offering to the customer on the commercial market. So, our ambition, also our focus is on MLE, we see that the, you know, the Ukraine war is showing that basically the system is getting advanced and will be getting advanced. So, we are really spending a lot of energy and discussion with our customers, you know, getting feedback also from the battlefield and also our partners or our customer, current and future customers on both sides of the Atlantic and looking at potential acquisitions there. So, it will be rather competencies, which we do not have currently under our umbrella, then getting another production facility production facility for commercial market firearms.

Jan Raška:
Okay, thank you.

Klára Šípová:
Thank you. And I see next question coming from Robert Miller from Reuters.

Robert Miller
Good morning. Can you hear me please? Okay. Thank you. My question is regarding the developments on in Ukraine, because obviously, huge arms shipments there. So, my question is, how does that affect your exports? Perhaps mean, in terms of perhaps necessity to enlarge production or an adjust to the demand from that part? Thank you.

Jan Drahota:
The truth is that, you know, all three facilities, which we have, have been involved in the help to Ukraine, and, obviously, it's, you know, you have to get it from short and medium term. And, you

know, you know, as unfortunate as, the situation is, it's necessary that we, that we are part of the efforts of the West to help Ukraine. So, we will be ready to provide whichever is needed.

I wouldn't comment for individual efforts, because I would say in terms of, you know, number of pieces sold or given or provided, it will still be way more from governmental side. And then from our side because governments play a key role there. So, it can happen that governments are buying from us and selling that. So, it's so or selling their stock, which they have and restocking the stock. So definitely, you know, I wouldn't call for an opportunity. So, I would resign from that. But definitely, it's I would say almost our obligation to stand firm on a side and act as our governments or partners ask us to work here.

Robert Miller
Thank you.

Klára Šípová
And other question from Wood&Co. company? Atinc, please go ahead.

Atinc Ozkan.
Yeah, related to Ukraine war. I do remember now and I don't know how reliable that piece of news was. Klara was help to clarify it a little bit, but I feel obliged to ask it again. I think few weeks ago, there was some news from Ukrinform. Those Czech officials when visiting Ukraine had some discussions regarding a potential CZ production line in that country. I understand this is very preliminary, but is there anything you could add to the news?

Jan Drahota:
No.

Atinc Ozkan.
Okay.

Klara Šípová:
Okay, thank you. Česká spořitelna, Peter Bartek. Do you have another question?

Peter Bartek:
Yes, on the dividend payout ratio, the 43 to 50% payout, I had impression on the last call previously that you will be adjusting the EPS, for the amortization of the intangibles of the purchase. I don't know how you call it which is quite substantial amount. So, if, that's, true, maybe would be useful. If you provide the EPS without this figure. So that's one question and second question on the stock options program, I didn't see the details. So, if you could elaborate on it a little bit, what is the strike price for the options, what are the conditions for allocation like EBITDA growth, leverage, whatever, whether there is a, for example, some obligation of the management to build and to hold some position in the company. So, more details about the stock, so, stock option program, thank you.

Jan Drahota:
Peter, if you can consult the H1 report, there are details on it. So, you know, instead of going there in h1 report, there is a real detail so, and you can come back to us, as far as the as the EPS is concerned, you are right. And we were discussing and it was discussion about the reasoning for the higher payout on a nominal on a basis of a pure EPS in 2021. So, we were saying okay, that you cannot look at EPS only on the low as reported because there are effects, which are, let's say, which show the cash flow generated, the real cash flow is higher because of the amortization.

So, I will say that I can provide I don't have it now, in my head, the EPS with amortization, I haven't done it. But, but please, I would just correct one thing, I didn't say 33 to 50%. I said at minimum 50%. That's my view on things. But we have not taken yet a formal vote on that. So that's the comment to that. I didn't say that the payout should be 33 to 50. But it can be I said that. My view is that should be minimum 50. And minimum 50. If I look at it, it's also reflecting the fact that the EPS as such is little bit downplayed by the amortization, that was my point there. So, if you have in reality, if you have let's say 50 60% payout from the EPS which are which are as reported, it will be effectively low, it will be effective low payout ratio because of the amortization there. So that's, that was the point.

Peter Bartek.
So just 50% or 50% plus would be from the same as reported EPS.

Jan Drahota:
Yes. Yes, yes. Yes. And yes, yes. And we have flexibility because of what I just said.

Peter Bartek.
Okay.

Klára Šípová
Pavel Ryska from J&T banka, do you have a follow up question?

Pavel Ryska:
Yes, thank you. So, one final question for my part, it concerns the increases in your product prices. So, it is evident from your numbers that the average product price is increasing this year compared to last year. But it also is it is also due to the fact that the proportion of long guns is growing. So, my question is, if we take it like for like so let's say the same product year on year, can you give us a color on how fast the prices are increasing? If they are increasing? Thank you.

Jan Drahota:
Yes, honestly, I don't have a weighted average price increase over the year I don't have it I don't have the weighted you know, weighted by the split of sales. We did increase the price of products and they were increases were in the single digit range to double digit range. I will say that, for me the more impact on the sales is or the split of or difference between number of pieces sold and the number of $ or CZK is reflected by two things is the is basically split, there is a split which is which is more weighted than the average price. There's more weight than the increase of prices. Once again, you know if you get one P- 10 as value or probably 1/3, or one brand or maybe 25% on brand value, so it's a huge difference. So that that has a bigger impact., I don't have a statistic for both brands on the average price increase and let's see weighted average price increase. I don't have it per se but as I say in most categories, we did increase the only a few categories where we didn't because we were able to take measures.

Klára Šípová
I see two follow up questions. One is Reuters and one is from Česká spořitelna. Have any follow up question?

From Reuters. No, not really. I'm sorry. I just forgot to take the head down. Sorry. Apologies.

The same from Česká, sorry.

Bloomberg.
Maybe maybe just a really quick follow up if I may from Bloomberg. So, I typed a question in the chat. But I think Mr. Drahota has already clarified that about the payout policy of at least 50%. In the future. I just want to clarify another thing that you said. Related to that, which is that you expect discussion with the management and presumably some announcement regarding this in in you said in three weeks, or in the coming weeks, I wasn't quite, the audio wasn't great today. So, I wasn't quite clear what the timeframe for the announcement is.

Jan Drahota:
Sorry for that. Yes, we have a, let's say, joint meeting of the two boards, Supervisory plus BoD, and my ambition is to close this gap. Because I know that I promised it to you guys. And I have we have not delivered yet. So, I would like to close it at least with a formal motion of the

boards, you know, to make sure that what is the let's say ambition of the management and supervision. So that's, it should be coming in, let's say three and a half weeks, kind of.

So, we will announce it when we so we will maybe discuss it during the figures for Q 3. We will also I think we should have a formalized point.

Bloomberg:
So where can we expect the announcement as part of the 3 Q earnings or before?

Jan Drahota:
I think that would you know, I don't know. You know, it's probably better to do it as a part of q3 when we're discussing q3 than to announcement on dividend policy because it will not give any information anyway, I think that we will be able to give better granularity in this q4 results. And so, you will not be surprised.

Bloomberg:
Okay, thank you

Klára Šípová:
Ladies and gentlemen. If you have no follow up questions, then I would like to thank both Jans, for the participation on the call. I would like to thank you for all your questions. And if you have any other follow up questions, please contact us via phone or via email. Thank you very much.