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Saab AB (SAABY.SE)

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MANAGEMENT DISCUSSION SECTION

Merton Kaplan

Head-Investor Relations, Saab AB

Good morning and welcome to Saab's Q2 Presentation Call. I'm Merton Kaplan, Head of Investor Relations at Saab. So, this morning, we released our Q2 report and we will go through that today in the normal hour session. We will deep dive into the business side and we'll also deep dive into the financial side, and that's why I have Saab's CEO, Micael Johansson; and, Saab's CFO, Christian Luiga here with me today. After the presentation, about 30 minutes, we'll have a Q&A and take your great questions, and then I will give back the word to Micael for concluding remarks, and also present our new CFO, and we will get back to that.

And, I think, with that, I leave it to you, Micael, to start the presentation.

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

Thank you so much, Merton, and thank you for joining us this beautiful morning in Stockholm. Let me start with some highlights from the quarter, and as you've seen, our order intake really shows how successful we have been in the marketplace lately and the demand in our portfolio is actually great. We have really good position with our portfolio and I see that that demand just continues, and this is the second strongest quarter we've ever had on the order intake side. So that is – we are strengthening our position all the time in the marketplace.

We still see a long term demand. I mean, all the projections we've seen on the European market has been on a 10-year perspective increasing dramatically, and now also attending the NATO summit last week seeing how many countries now, 23 out of the 32, supporting the 2% floor target, I would say, when it comes to defense spending and also the NATO Alliance sort of Western support of Ukraine and how to sort of spend money on that

from the member states going forward, also adds to that long-term demand, I think. So, there are fundamentals in the marketplace supporting the long term demand.

That goes for Ukraine as well, of course, where we have lately seen a package from Sweden, SEK 13 billion, including two airborne early warning aircrafts that will – then had led to a replacement contract for another GlobalEye for us that then expedited also the delivery pace on the existing contract. So, that's also a sign of how important the support of Ukraine is, of course, but that adds to the demand as well.

For us, I must say that the focus on sort of supporting our deliveries and commitment to our customers, I've underlined that before, is so essential going forward and all the initiatives, and I will come back to that, that we're doing to increase our capacity and build up capability to support our growth is very much in focus. But then, again, as I've said before, we cannot only look at here and now and capacity buildup. We need to look at the capabilities needed for the future. So we are continuing to invest heavily in R&D and that is in areas like how we use AI to digest information to quickly get to a situational awareness picture for our users, that is really, really important, but also how we work with autonomous systems, both when it comes to counter the threats of the drone technology that is now in place and swarm technology, but also how to use that in our capabilities going forward.

Those are examples of things and partly we have demonstrated new capabilities during this quarter to our customers. So we are relevant also going forward in this. And this is really, really instrumental to us in the next few years to sort of keep up with embracing new technologies to be relevant in the 3-year, 5-year, 10-year period to come, and the pace of technology, as you know, is incredible out there. So this is really also important for Saab.

Looking at the numbers as such, as I said, the quarter was really strong when it comes to order intake, almost SEK 40 billion, and that is a big increase year on year. And also the order intake for the half year, almost SEK 60 billion, SEK 58.2 billion is great, and I see the demand is really – and the activities in the marketplace are really, really intensive out there. I'm really pleased with the growth, of course, continuing to grow to 22%, 21% organically, and continuing with the trend to increase our EBIT more than our sales growth is good. That's what we have said and that's what we need to do. We do have a negative cash flow this quarter and in the first half year, and that's not unusual when it comes to our type of business and in our segment, and we have different large payment milestones looking at different quarters over the year and, this year, we do have large payment milestones in the third and fourth quarter, which means that we are extremely confident that we will have a positive cash flow also this year, which we've said before. And, actually, already the first two weeks of July, we have received large payment. So, that is also solidifying my view that I'm confident on that we will deliver a positive cash flow over this year as well.

And, looking a little bit more in detail on the order intake, a big portion of the order intake, both when it comes to the quarter and when it comes to the half year, is in the international side of things. So we do keep our proportion – a part of sort of the defense increase – the defense spending in Sweden, but the international orders will grow more going forward, and we see that specifically in Europe, but also elsewhere, is growing a lot. And a couple of examples on this is, of course, that the Dynamics Carl-Gustaf contract with Poland was solidified this quarter. We announced it earlier, but we had a few sort of terms and conditions that needed to come into place before we could actually recognize that contracts in our books, and that's the SEK 13 billion. We have received more contracts both within Surveillance and Dynamics, when it comes to a Western country, that we can't reveal which country that is, but that is within their portfolio. And, as I said, the replacement contract for the two airborne early warning aircrafts that will be delivered to Ukraine will be that we now get a third GlobalEye and we now work with expediting the whole delivery schedule for the GlobalEye to Sweden.

We also have received also, as a consequence of all the packages to Ukraine, new contracts on the Combat Boat 90. So that part of the organization is really booming now with continuous production of Combat Boat 90s. And, we have several orders also in the naval domain, composite superstructures and both sensors and EW equipments on frigate ships to certain countries. So it's a really good spread of things over the portfolio, I must say, and it's a record high order backlog that we now have of SEK 183 billion supporting, as Christian will come back to and talk about, the coming growth for the company.

Looking at the backlog, I think a few comments on that. It's quite interesting to look at. We are growing 20% and, while we're doing that, we continue to increase our book-to-bill, which is a good sign of what that supports the long term guidance and the target we have on a 15% CAGR when it comes to sales growth, and that is really impressive I think. And the other portion of this is how the backlog has developed over the years when it comes to the – how it's divided between the Swedish part of that and the international part of that. And, I've said that before, we will grow more internationally, but we will keep our position being roughly a third, a little bit more of the Swedish defense spending, and that is what we see here now. So in real numbers, we have increased our backlog with 88% since 2021 up to now and the biggest growth in that is on the international side. And the Dynamics and Surveillance is, of course, the big driver of this, and we're not basing our plans going forward on the mega deals, as I've said before, even though those will be, and we're working hard on the mega deals, mega deals being, for example, Gripen contracts or submarine contracts or GlobalEye contracts, if they also adds – they adds on top of sort of what we plan going forward, but it's a sort of solid sort of way forward when it comes to our growth now.

Looking – a couple of comments on, on each business area then, high pace in the programs, of course, in Aeronautics when it comes to deliveries for Sweden and Brazil when it comes to the Gripen program. We have better profitability, supported a bit by the higher volumes, of course, in the area, but also that we have a slight recovery now in the civil business, which is nice to see, is something we have been battling with for a while, which we call the Aerostructures business, but we're getting better and better now and we're getting on the right side soon on the profitability level there.

We still have sort of an under-absorption when it comes to the T-7 production, the training aircraft together with Boeing, which we are manufacturing in Indiana, and that is sort of we are in the manufacturing phase, but we are in the low rate initial production phase and there will be some time before we get into the type-certificate phase and the Milestone C, as they call it in US, when the more full rate production starts. So we have to carry this, but it's a great facility we have there, and we are working, of course, to optimize this as we go along.

We have a number of campaigns that is of interest for us, working hard on those, of course. I would like to mention Thailand, which I think is the – maybe the most imminent one for decision. They intend to take a type selection of which fighter system they're going for, I think, it's between us and the US and F-16s, and that is hopefully within a short timeframe. And then, they will go into a budget sort of discussion over the fall to come to conclusion later this year.

We have Colombia that is also in a decision phase, sort of tailing then maybe Thailand on that, and that is a – it's all – in all countries, those are political decisions, but we have provided a very strong offer also in Colombia. And then, we have the Philippines that have just now – started or restarted their acquisition process and they're now looking at more aircrafts than earlier, they have taken an acquisition decision memorandum in the Parliament. And so now we're into that process going forward. And, of course, Brazil continuing to invest in Gripen E going forward is important to us. So, there are a number of initiatives on the Gripen sides that we are putting a lot of effort in to also sort of win mega deals going forward.

Dynamics have a very strong order intake, of course, record high for them in the quarter, strengthening their backlog tremendously. This strong growth that we see in Dynamics quarter to quarter of 37% is still mainly driven by Missile Systems and Training & Simulation. They have three – at least three legs that are really strong, missiles, training and ground combat. So the capacity initiatives, the investments we're doing will still come into play, of course, going forward step by step, but it's very much a growing business and, of course, the scale from high volumes have now resulted in a very much increased profitability level also in this part of Saab. So focus on capacity expansion which is generally speaking truly important to Saab, of course.

Surveillance, also have a good order intake, continuous high mid market interest. They have an excellent portfolio and we'll continue to grow, of course, and have a great interest in the market. The growth has been, of course, driven by very much a high activity in many businesses, but we do have a mix of things in surveillance that have impacted the market margins a bit in terms of the few legacy contracts that we have to sort of handle in the quarter. So, we need to manage that and that is, of course, something that is not something for the future, but rather something we have to manage now. And then, of course, they employed a lot of people and that is the onboarding process and takes an effort. So, that has affected the margins a bit as well. But surveillance, of course, will be a high margin business for Saab going forward as well.

And then, we have had a very important delivery, a second airborne early warning aircraft to Poland. So we have now delivered in a very short timeframe two aircraft to Poland, which is I'm really pleased to see that we managed those deliveries within such a short time.

Saab Kockums have grown a lot quarter-to-quarter, also half year to half year, and that is all about the mix between underwater business and surface business and how we see the mix of the support contracts and production and development contracts. And that, I think is the mix that I think is good for Saab Kockums and they are building that mix going forward for a nice growth and also a good EBIT level, which is nice to see. We had a very important launch of the refurbished and the overhauled Södermanland-class submarine that is now back in the water, and that is also a sign of how capable this organization is now when it comes to submarine business, which is great to see.

Combitech is also carrying on in a good way, growing slightly 6% quarter-to-quarter and increasing the profitability level. It's a high interest in Combitech expertise now, especially within the total defense sort of area, where many authorities and also private company needs help and also the digitalization, where they are strong and in the cybersecurity area, where we run a number of security operation centers and all metrics are going in the right direction for Combitech.

We have divested early in July our Norwegian business that is 30 employees of the thousands that Combitech's employs. The focus is now mainly on Finland and Sweden when it comes to the Nordic business. And we have also a new center established in India, not a big one, but to support Saab in India and also, of course, a couple of other companies from India, where we think we will be able to grow that business. So, that is a good development I think for Combitech going forward, but the main focus is still of course the Nordic business.

Digging in a little bit more in the capacity initiatives that we are working with, I think this is really a focus for Saab and of course, we continue to employ people and as you can see, we have a net increase this half year of 1,600 people, but we cannot just only continue to employ people to manage our revenue growth. We need to sort of take a step back to look at how can we atomize our production, how can we industrialize things in a more optimized way to sort of support the volumes that we see going forward, and that is the key, I think, to continue to grow Saab going forward. So there is a mix of things happening now.

And, if you look at aeronautics, we are investing in Linköping, in certain things like in surface treatment and painting facilities, and a couple of other things to support the ramp up of the Gripen production, but also the GlobalEye, actually, that production in Linköping. And then, the increase of workforce in West Lafayette, Indiana is important to support the growth of the T-7 going forward.

Dynamics have many initiatives, going everything from building new facilities in Karlskoga and in Linköping, to production in Linköping and a Fuze Assembly facility and other assemblies lines in Karlskoga. So there are a lot of construction activities going on in that part of Sweden right now. But not only that, it's also of course about optimizing the production through atomization. So we have implemented robotics capabilities in parts of the production and we are also looking at sort of the maybe you need to sort of reindustrialize things to actually, as I said, to optimize the flows in production going forward. Then you have to have redundancies.

So we have, as we've talked about before, started a facility development in India supporting that market but also the export market. And then we have decided to build a manufacturing capability to support both the ground-launched small diameter bomb production, but also support weapons production in the US. We haven't officially stated yet exactly which state that is, but we have decided. So that's going to be an imminent sort of communication, and these things will come into play 2026 roughly timeframe. So, there are a number of things happening to support the growth of dynamics going forward.

But also, from a surveillance perspective, we've done a lot. We are of course expanding in Stockholm. We are relocating to Solna Strand to support that capability. We are implementing and ramping up in the UK to manufacture radar capability in Fareham. And we are also booming our underwater capability in the UK and we'll be inaugurating later a big news site in Australia supporting our naval business in Australia. We are employing a lot in Australia and that business is growing a lot as well.

And also in Finland, we have another new facility for production of our EW equipment, which is called Sirius Compact, which has been a great success since we implemented or industrialized that innovation, I would say. So – and on the Kockums side, so our Kockums side, we will move our facilities from the engineering perspective to Lund from Malmö, which will also optimize the engineering capabilities in that site. There are so many things going on in Saab when it comes to capacity increases and optimizations of ways of working and our flows, and this is really highest on the agenda every day from corporate management to make sure that this comes into play at the right time.

And this is not without pain points, I wouldn't say that. But generally speaking, this is going well. I would say. When it comes to sustainability. We had a big breakthrough this year, this quarter. I mean, when it comes to being the first defense company to receive the SBTi's approval for the 2050 long term emission reduction targets, which we are the first company to establish. So 2050, we will be completely neutral when it comes to all scopes of our sustainability efforts, Scope 1, Scope 2 and Scope 3. We have taken a decision supported by the annual general meeting to include a diversity and inclusion target in the performance plan for senior management, which is really pushing us in the right direction to increase our share of women employees to start with and that is already showing signs of improvements across the company, which is great to see. That is really important and good for Saab.

And looking at how many people we now employ, we put a lot of effort in the really diligent anticorruption training program that we have. We have a best in class program when it comes to anticorruption and compliance and a Code of Conduct that is really, really sophisticated and good, and that is so important now that we work with that continuously when we have so many new employees coming in to the company.

And I also want to underline, we have taken the decisions to be a leader in sustainability within our business type of segment going forward. So this is something we put a lot of effort in from a Saab perspective.

So finally, from my side then, priorities are of course, obvious from my side and probably you recognize many of them. So many things are happening within EU and NATO of course not at least looking at the summit that I attended last week. There will be of course lots of things happening when it comes to establishing regional defenses from NATO, and we will receive our capability targets in Sweden and all that. So that's really high on our agenda to support that going forward, and also all the initiatives within EU.

The strong demand that we see, deliveries, the capacity ramp up that I've talked about is really, really important to us, including also, of course, the onboarding of all our new employees, adding to our excellent existing employees, but not only managing sort of the capacity, as I said, but also continue to have the strength to invest in new technologies and quickly industrialize those to offer something in the marketplace, of course.

Then, the ways of working and how you work with software development and how you digitalize lots of what we do is also really important to us to be competitive going forward and to quickly shorten the lead times in what we offer to the marketplace. I haven't said too much about the supply chain risks, of course, that is really, really important and we monitor, of course, all the – and follow strictly all the sanctions which might lead to – we have to find new suppliers on certain raw materials or it will be that our suppliers will have to find new suppliers for raw material and we have to create redundancy in this. And, sometimes, we regionalize our supply chain as much as we can. So this is something that we work diligently upon as well.

We have a little bit of sort of time to do these things since we carry a little bit more in inventory and in stock. So but it's something we have to work with and we are not, of course immune to the things happening around us when it comes to geopolitical tensions when the – with the effects it has on restrictions and supply chains. So, lots of good things happening in Saab, lots of focus, fantastic support of our employees to grow this company, and we do great things.

And, with that, I am really pleased with the quarter and I, by that, hand over to Christian to talk a little bit more in detail about the numbers.

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

Thank you, Micael, and I will give a little bit more about the financial perspective and, on the screen, you see now Södermanland in the water. I think it's a fantastic picture of a delivery, but also a great competence we have and a great submarine actually. So with that, I just wanted to summarize the quarter, as I always do, when I think about for this quarter. Well, it is a strong order intake as Micael talked about and we also, I would like to emphasize the margin improvement we continue to do and we also do in quarter two. And then finally, we have a strong financial position, and that will be even looking better in the numbers as we deliver a positive cash flow for the year. So that's my summary of what I think is important to think about.

And if we start on the order side and look at how this new big order intake has over the last 12 months, SEK 100 billion coming in, how has it then populated over the years? And I think this is actually a picture that gives some comfort. The population has been very much over these coming three years and gives us then comfort for how we can deliver also a step-up in growth. It puts more than emphasis on capacity, as Micael talked about, and not so much about getting orders into the books.

It was [ph] 82% and 80% (00:26:53) on the half year coming from international orders, which means that sales will also move from today, 40% going into Sweden, probably if we don't get more orders from Sweden than we do internationally, a little bit more on the international sales over time in our books. This also shows that we have a good step-up for next year, already SEK 52.4 billion in the books and we have had SEK 28.6 billion in the books for this year. And if you add that to the current sales and look at what we normally have in order to sales in a half year, you will see that our guidance and where we believe we will be in the guidance is probably in the upper range for the sales for this year.

A final comment on this, that we will come back to and this also reflects then in the timing of this order intake is that we have moved from 22% to 38% just in two years' time on how much the share of Dynamics order book is of the total backlog. And that, of course, drives a shorter pace in delivery but it also will mean that the Dynamics income statement will have a bigger portion of the income statement in the coming years.

I will skip the quarter and do some reflections on the half year. Half year, we have then moved up in sales, as Micael said. And if we look at the EBIT increase from 8.3% to 8.6%, the main drivers are the sales growth, but also a margin improvement from scale over the OpEx, and that I will come back to shortly.

Tax rate is impacted last year from the sale of the divestment of MTM, which gave a positive SEK 270 million income to the income statement and also to Surveillance, which I'll also come back to. Other than that, there's no big surprises or things in our income statement.

We did have in quarter one a big financial impact from currency effects which we see in quarter two is starting to come back and nothing that is a long-term thing, but we will be closer to last year's number over time when it comes to financial net with this kind of balance sheet that we carry right now.

If we look at then sales, we as I said, Sweden now stands for 40% of the sales in the quarter and pretty much the same in the half year. We have a CAGR over the last 12 months, which is similar to what we have in the first half year. We do see strong delivery and impact from growth in all business areas. If you look at half year, it is pretty much 20% for all business areas, except for Kockums, where it is 44%. So we have a strong momentum in all four business areas.

And the EBIT margin and the EBIT growth is then coming from sales, as I said, increasing. But if you look then on OpEx, a couple of reflections. We do have in the investments and we'll come back to that in the capitalized R&D, no increase. We have the same capitalized R&D this year as last year. So the first reflection could be from a viewer, don't you invest in R&D? Yes, we do, but we carry much more of that in the income statement than we have done previously.

So R&D cost increases with 37% in the first half year. And if you put that 37% together with what we have invested then in the balance sheet, we will have a total increase about 60% and 70% on half year. So we do invest in R&D, but it is more hitting to our P&L in this half year.

And then if you take away those 37% and look at the rest of OpEx, administrative expenses, marketing expenses, et cetera, and the depreciation, they are around 13%, 14%. So we do have a scale on top of those kind of costs. And this is what we have said also previously. We don't seek to scale on R&D, but we do seek to scale on marketing, administration, et cetera. So, this follows the pattern we have talked about before.

If we then dip in a little bit to the different business areas, Micael have touched on them. I'm just going to go through it a little bit from a financial perspective. The first thing I wanted to point out, we had actually quite high

Aeronautics growth in quarter one, over 30% and we said that is not representative for the year. It will come down and now we see it has come down to 10%. So that's just confirming what we said in the first quarter.

And, secondly, as we have seen, Dynamics is pushing now quite hard with growth in this quarter. We there said, we had a very low growth in quarter one, and we said it will come back from quarter two going forward, and it will come back now and it is proven to come back from quarter two and will continue forward. So now, we do have a better growth momentum and that, of course, will impact the margin and will support a higher margin than last year as we go forward, so without guiding on what the margin will be.

On Surveillance, we did have an impact on the half year last year of SEK 270 million, and we did have it on the full year because it was a quarter one impact. Last year, we reported in Surveillance a 11% EBIT margin for the year. But in reality without those MTM profits, it was only 9.5%, and that is the reference point that we should think about when we look at the margin in Surveillance. This quarter, as Micael said, we had some legacy contracts where we have made some write-downs and it will be a business area where radar and airborne early warning will drive over time the margin upwards.

Kockums, we said last quarter that operating margin should be around 8% to 10% and we will get there in some quarters maybe. I'm really happy to see we already came there in quarter two, we are at 8%. We still are moving up a bit in profitability in the underwater business, but the surface ships and composites, et cetera, that Micael talked about is supporting the business in a balanced way. So we do get a [ph] okay-ish (00:34:08) margin of 8% anyway in the Kockums business. Good.

Moving into cash flow, always interesting, and we started out with a negative half year, very much something that we have a understanding and control of in the sense that customer payments in 2023 was in some of our bigger programs heavier on the first half year and now they are heavier on the second half year. And then we have also the new orders that we have taken in over the last 18, 24 months started also coming through in both milestone and scheduled payments that we then will receive in the second half. So those timing of customer payments is something we have quite good visibility on.

Inventory has increased in the first half year, partly because of things that are supposed to go out in delivery and [ph] not least (00:35:10) in Dynamics in the second half, now when growth is picking up. But also, as we grow, we do have a touch of increased inventory as we grow more than we expected in the beginning of the year.

Finally, investments, that's the smallest part of this negative cash flow and something we have talked about and we have expected and something that is actually moving on as we expect internally. And, mainly then, as we have said before, I would just confirm that it's Dynamics and Surveillance driving that investment growth. And then, we can see on the right side that we have moved from SEK 1 billion to SEK 1.8 billion in the tangible assets and confirming what I said before, intangible assets, the R&D is not increasing at all in the balance sheet, but in total R&D spend, we are moving up.

We do have a solid balance sheet, I say, and then you can look at this picture and say, well, it goes downwards. Yeah, but we still only have 0.33x in net debt to EBITDA. We have SEK 2.4 billion in negative or in debt on the net side. Actually, the lease liabilities are SEK 2.7 billion. So taking that out, we are on sort of the pure debt and cash point of view quite neutral, and we do expect a positive second half.

So I still think we have a solid balance sheet. And I think that was also something that was confirmed by our BBB+ investment grade rating that we received from S&P now during the second quarter, which is then a good confirmation and then also good, I think, for Saab now, growing as a company and establishing itself on the

markets and we'll have to sort of play on the capital markets like anyone else over time. This is a good foundation to have going forward for the company, either it is growing our investments in order business development, partnerships or in M&A over time.

Finally, last quarter, we upgraded our sales growth. As we indicated, we believe we will be in the upper range of the 15% to 20%. We still believe then and did believe also last quarter that our operating income growth will be higher than sales growth. So, margin will improve and the 70% cash conversion is a long-term thing. But to do that, we also need years with positive operational cash flow. This year and next year, we said, we'll be a little bit pushed by investments and that we should expect and we see that, and that has not changed and it has not changed that we also believe that we will have a positive operational cash flow for 2024.

Thank you very much.

Merton Kaplan

Head-Investor Relations, Saab AB

Thank you very much, Christian. So, we have a strong interest from what I can see online, which means that we have to speed up a bit so we can get everyone's question. And if you still don't know how to dial in to the conf call, we have the details on the press release and the report that we sent out this morning.

So, without losing time, I also want to highlight that, please, do maximum two questions at a time because we have several on the line. And then, in the last couple of minutes, Micael, I will get back to you to present [indiscernible] (00:38:48). So, moderator, please go ahead and start the Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] The first question is from Kseniia Maslova, UBS. Please go ahead.

Kseniia Maslova

Analyst, UBS AG (London Branch)

Q

Hi, everyone. Thanks for taking my questions. I have two, please, if I may. So first one, maybe if you can just give us a bit more color on the uplift in Dynamics margins in Q2, sort of, the building parts of that. And how should we think about these going into second half of the year?

And then my second question will be, during the call, you made a quick comment that you need to take a step back and see how you can scale up in a more optimized way. I just want to double check how can we interpret this statement? Are you sort of doing some internal improvements program, potentially slowing down the rate of employee additions because, I should say, in some divisions, especially, Surveillance, potentially the margin improvements or the pace of those has been a bit slower than what we would expected maybe 12 months ago? Thank you.

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

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So if I start with the second question, Christian can come back to the first one. I didn't mean that we are slowing down our capacity increases in any way but while we are optimizing the way we manufacture things, specifically

in Dynamics and Surveillance, we also need to take a look sometimes at how we have industrialized for volume production or even some products, we may have to do some redesigns for better manufacturability. That is not slowing down what we're doing right now, but it will support even more the potential sort of volumes going forward.

So sometimes you have to fix the root causes also while we're doing sort of optimization. So, it's just sort of doing what we do in a better and better way. It's not sort of taking a step back and halting anything. I didn't mean that.

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

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So on Dynamics, as we all know, we have received fantastic orders into Dynamics. We have a great potential. Therefore, we are building capacity. We're building a bigger base to produce from. First quarter was a very weak sales so we didn't get enough sales to meet what we are starting to build up in production. This is the simple way of explaining it.

Now we're moving into a quarter where we have numbers that better match our capacity and, therefore, also margins better match the margins we should be able to deliver over time, i.e. higher margins that we have had before.

So, that's the simple explanation. So continuing on this volume base, we should be able to have a better margin than not having this volume base. So, that's the simple answer to that.

Merton Kaplan

Head-Investor Relations, Saab AB

A

Thank you. Thank you, Kseniia. We have to move on to the next person.

Operator: The next question is from Aymeric Poulain, Kepler Cheuvreux. Please go ahead.

Aymeric Poulain

Analyst, Kepler Cheuvreux SA (Switzerland)

Q

Yes. Good morning. I've got two questions. The first is a follow-up to the development of margin at the divisional level. So you suggest Dynamics should retain this superior level of margin going forward but Surveillance also was a bit weaker. You allude to some contract, legacy contract being written down. Does that mean that the margin dip is kind of temporary and we should see also Surveillance margin going higher as we move forward? That's the first question.

And then, secondly, I think you mentioned the urgent need to support Ukraine. However, in the last Republican Convention, we heard both the VP and Donald Trump not agreeing with that view. So, in preparation for this, first, do you have a quantification of the impact of the Ukraine military aid in Saab's number and, indeed, what would be the most likely scenario in your view at this stage on the Ukraine war and its impact on Saab's business? Thank you.

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

A

So let me start with the second question again then and Christian could take the first one. I won't not say that I don't have a view sort of on the administration and how that sort of develops going forward in the US. But the most important thing is, of course, to recognize that Europe is stepping up and that needs to be something that

we continue to do as countries and defense industries and as a continent in terms of taking a bigger responsibility for our security in deterrence and resilience and thereby investing more, and that we are seeing and we should do more, I think, independently of the administration in the US.

I can also recognize from the summit I attended last week the huge support on from the members in the Alliance to support Ukraine with the \$40 billion support going forward, but also to coordinate now the efforts, which US had earlier from the Ramstein group. So there is a big Western support to continue to support Ukraine. That's where we are, and then continue for Europe to step up, and then we'll see what happens.

We do not – I cannot calculate exactly the number which is related to our growth or our revenue when it comes to what is Ukraine support or not because we don't exactly know what different countries donate or what they actually use, with which we deliver to replenish their own stock or sort of grow their own capabilities in-country. So that is incredibly difficult to sort of pick a number and decide what is Ukraine related. But as such, generally speaking, of course, there are three parts, support Ukraine, replenish stock, which has to be done because of the support to Ukraine from different countries, and then to step up and increase capability and stock levels. But that is sort of in combination, something that's happening in the marketplace.

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

A

On Dynamics, of course, we don't guide on business areas. And then when you say it's going to be higher, everything is relative to something. So the question is just to what? And I'm not going to comment on the quarter and the quarter margin, but if we looked at last year and what we said last year we said that we had a margin last year and we said, as we scale up and get bigger volumes, that should have a positive push on margin. Meanwhile, that should be more than compensating the cost we're increasing than the base and the cost of growing and how much that is, we will not talk about.

Aymeric Poulain

Analyst, Kepler Cheuvreux SA (Switzerland)

Q

Great. Thank you.

Merton Kaplan

Head-Investor Relations, Saab AB

A

Thank you. Shall we move on to the next one?

Operator: Next question is from Virginia Montorsi, Bank of America. Please go ahead.

Virginia Montorsi

Analyst, Bank of America Securities

Q

Good morning and thank you for taking my question. Could you elaborate a little bit more on the profile of the people who you're hiring, particularly in surveillance? Is it mostly a younger workforce, a straight out of school, or is it more seasoned professionals? And specifically for surveillance, should we think about this hiring increase as something that becomes kind of the normal level for next year as well or is it mostly trying to catch up with demand and supply this year? Thank you.

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

A

Well, I would say that, looking at the competencies that we have in our employment structure right now, of course, quite a lot looking at surveillance is related to software development, AI knowledge, data, engineering, that kind of capability. Looking a bit broader on this, it's every type of expertise from skilled production personnel to support people as well. But if I should pick some sort of center of gravity, I would say, it is a lot related to software, AI capability and data engineering that we need to add sort of competencies on that area, which we have done in a successful way. Quite a lot of that is coming, I think from sort of rather new sort of graduated engineers, but not all of it. We also employ skillful people with experience from other companies as well. And so, but of course, there's a youngie generation coming into Saab, generally speaking. Yes.

Virginia Montorsi

Analyst, Bank of America Securities

Q

Okay. Thank you. And going back to the surveillance margins...

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

A

What was the question...

Merton Kaplan

Head-Investor Relations, Saab AB

A

The cost of the...

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

A

The cost of the...?

Virginia Montorsi

Analyst, Bank of America Securities

Q

The hiring [indiscernible] (00:48:22)

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

A

Okay.

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

A

Okay.

Virginia Montorsi

Analyst, Bank of America Securities

Q

...is it something that will continue for this year.

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

A

Because, I mean, if you look at the difference, I mean, surveillance and dynamics is recruiting most people. Dynamics is recruiting people that is easily getting into work in a production plant and can start to be sort of allocated into the production and cost then and do a good job. And in surveillance, we're also hiring a lot of good

people, but it takes a longer time and it takes up to four months to get them into to be sort of productive. And, therefore, there's a higher cost when you have this kind of big pace of increase to unallocated cost until we get them into the programs.

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

A

I mean, and I said before that, yes, of course, we will employ people and we have some attrition maybe it's not high, but I can't see going forward in the coming years that it will be this type of sort of growth net that we have seen sort of the last couple of years now and this year. So there is new ways of working, supporting and digitalization, transformational. We do software, for example, that support sort of a little bit less of the workforce then. So – but the onboarding is slightly more expensive, of course, in that kind of area than it is in the production side.

Virginia Montorsi

Analyst, Bank of America Securities

Q

Okay. Thank you.

Merton Kaplan

Head-Investor Relations, Saab AB

A

Thank you, Virginia.

Operator: Next question from Sam Burgess, Citi. Please go ahead.

Samuel Burgess

Analyst, Citigroup Global Markets Ltd.

Q

Hey, morning, everyone, and thanks for taking the question. So firstly, there were some big working capital movements in the first half driving that negative op cash flow. Fully understand that cash can be very lumpy, but I just wondered how much of visibility and confidence do you have that that will reverse in the second half and you'll meet that positive op cash flow guide for the full year?

Second question was just around the corporate costs, fairly high growth in H1 corporate costs at the EBIT line, even stripping out the FY 2023 exceptional items. I just wondered, is recruitment a significant part of this growth? Any clarity there would be really helpful. Thank you.

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

A

So on the cash flow side, I am really confident that we will be positive this year. I said that in the call, and I reiterate that also by the fact that we have already, in the beginning of July, before this call received big payments. So it would have looked differently if the quarter had been a couple of weeks longer, but it's not like that. It's really digital when you get the cash in. So but I am confident and this is things we have delivered that will get us payment and then we have a few milestones that we will deliver upon which will get us payments over this third and fourth quarter. So, yes, I am confident.

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

A

On the corporate costs, the lesser part is the employment. We don't try to or force to hire at the same pace as we do in production on people and corporate, and we try to also keep the scale on corporate costs. A big portion comes from IT and security, to be very clear, which that is a cost that increases together with actually, you can call it temporary. We have built up a recruitment body on corporate that actually helps also the business areas.

And, finally, on corporate, we do have a high cost for our share program. And as long as our share price continues to improve, which is good for our shareholders, it also is good for our employees, and then that's a cost that we carry in our income statement.

Samuel Burgess

Analyst, Citigroup Global Markets Ltd.

Q

Great. That's really helpful. Thank you, guys.

Operator: Next question is from Erik Golrang at SEB. Please go ahead.

Erik Golrang

Analyst, Skandinaviska Enskilda Banken AB

Q

Thank you. Two questions, then. First one on coming back to cash flow and just from a bigger perspective on what I thought that you're becoming a much bigger company and more diversified between contracts and clients and that that would reduce cash flow volatility a bit, but maybe not the case or not the case yet, but is that something you see moving forward?

And then a second question on guidance for the full year, what's holding you back there from an upgrade given you lead – you don't need much to hit the very top end or even top the top end for the full year. Is it a capacity issue or just some timing uncertainty? Thank you.

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

A

So, well, I mean, contracts within Surveillance and Dynamics, if I take that as an example, all the time they representing a bigger portion of the company will probably lead to more sort of a smoother cash flow profile, but depending on the contract setups and how they are structured. But you're right, it would get to that point in the end, but it's still a bit lumpy over the quarters. So, I would say, over the year, depending on how the contracts are designed. But, generally speaking, the mega deals as such are more lumpy when it comes to payments. So when we have less megadeals in the structure going forward, even though I want them, of course the cash flow will smooth out. Yes, I support that.

And second question was?

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

A

That was on the guidance for the year. Well, what will make it...

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

A

I mean, listen...

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

...above [ph] 20% (00:54:17)?

A

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

...look, I mean, I said we will be in the upper range of that that guidance. Now, I – I still want to be careful about sort of all the things I tried to describe here on capacity increases that we have everywhere ongoing, step by steps come into play, and the more they come into play and they start sort of being operationalized, I will be more and more confident in how the growth looks like. So that's sort of a balance that we have to look at. That's what it is.

A

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

Good. [indiscernible] (00:54:50) to round off then.

A

Merton Kaplan

Head-Investor Relations, Saab AB

Thank you, Micael. I want to have one more question...

A

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

Okay.

A

Merton Kaplan

Head-Investor Relations, Saab AB

...and then, we try to wind up.

A

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

One more?

A

Merton Kaplan

Head-Investor Relations, Saab AB

Yeah.

A

Operator: The next question is from Henric Hintze, ABG Sundal Collier. Please go ahead.

Henric Hintze

Analyst, ABG Sundal Collier AB

Good morning. I just want to sort of follow up on two of the questions that were asked earlier. You say that it's impossible for you to calculate what portion of your growth or revenue are related to Ukraine in some way. But can you maybe give us some color on what share of, for example, Dynamics sales and the growth there is driven by consumables, things like ammunition and AT4, NLAW, things like that, which one might assume are being boosted by Ukraine?

Q

And secondly, on cash flow, you seem very, very confident that you will reach the target. So, my question is, it's quite an unspecific and not very aggressive targets to have positive cash flow. If you're so confident, why not increase this target?

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

A

Well, I don't know whether you want to comment on the first one. It is really difficult, actually, to give details on and quite sensitive also actually to talk about sort of how much of a portion of what is being delivered from Dynamics ends up in Ukraine. Of course, the growth, as I've said on these three parts is driven by Ukraine to some extent that we deliver directly to Ukraine. Countries donate, we replenish stocks, and we also help countries build their own defenses. The mix of that, I don't want to go into actually.

Why don't we upgrade our cash flow more specifically? Well, I think we are in a business where cash flow is a bit lumpy, everything I'm saying is that we are very confident on delivering a positive cash flow. We've never delivered any guidance on a specific number or a specific range on cash flow. We will come back to that when we feel more confident and it's more sort of – more of a predictable exactly over the quarters. But still, you have to respect the trade-off between capacity increases, delivery milestones and the payment structures that we have. And I can only say and reiterate again, we have received large payments in July. We have more to come during the third and fourth quarter and it will be positive, I won't go further than that.

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

A

I just wanted to make a remark. We have given a guidance of 70% on the medium term target in the cash conversion, and that is a clear guidance...

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

A

Absolutely.

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

A

...number for you. And then...

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

A

That's correct.

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

A

...between the years, this is not a stable one type of business company. This is a growth company with a very diversified portfolio and a lot of opportunities and I think the best thing for me at least as a shareholder is to make sure we grab these in time and do the right thing at the right time. With that, we're quite confident then that can deliver 70% cash conversion and we're super confident that we will have a positive cash flow for the year.

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

Thank you. And let me just start by saying a big thanks to Christian for his excellent commitment to helping this company grow and your excellent work.

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

Thank you.

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

And it's been a privilege and an honor to work with you, and I wish you the best going forward now in your next adventure.

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

Thank you.

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

But I also want to welcome Anna, who is my now excellent new CFO from 9th of September, who has a great experience from Ericsson, but also from Saab, working with us for 10 years. So, just give a short description of herself.

Anna Wijkander

Deputy Chief Financial Officer & Head-Corporate Control, Saab AB

Thank you, Micael, and first of all, thank Micael for giving me this opportunity to take over this challenging and exciting role as CFO after Christian now in September. So, as you said, I have been within Saab for 10 years almost, and I have been working in various positions, both within business area as CFO, and also within group, and the last three years, I have been the Deputy CFO of Saab and working as Head of Corporate Control. So, I've been working very closely with the global finance management team and the group management team and I think I've also got a good knowledge about our company and our challenges. And also know a lot of people, which good for the next position that I'm now taking.

As you heard today, we are in interesting times. We are in a growth company, we are building capacity. And I think it's going to be fantastic to be part of this journey, contributing to our improving performance and also focus continuously on the capital efficiency.

And I think – I mean by that, I will come back the next quarter and present our financials together with you, and yeah...

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

You will get much more exposure next time.

Anna Wijkander

Deputy Chief Financial Officer & Head-Corporate Control, Saab AB

Yeah, I will. Now just a couple of minutes. So, thank you and see you.

Micael Johansson

President, Chief Executive Officer & Director, Saab AB

Well, thank you all for joining us today and for taking a big interest in Saab. It is exciting times. It's tragic that we have a war, of course, but we have so much to do to create defense and deterrence capabilities for so many countries, and I'm so proud of this company and our employees, how we are supporting this adventure going forward. So thank you so much and I wish you the best of summer.

Christian Carl Peter Luiga

Deputy Chief Executive Officer & Chief Financial Officer, Saab AB

Thank you.

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