Bodycote Trading Update Call

Transcript

11/19/24

OPERATOR

Good morning ladies and gentlemen and welcome to the Bodycote Trading Update call. At this time all lines are in a listen only mode. Following the presentation, we will conduct a questioning answer session. If at any time during this call you require immediate assistance, please press *0 for the operator. This call is being recorded on Tuesday, November 19, 2024, And I would now like to turn the conference over to Jim Fairbairn. Please go ahead.

JIM FAIRBAIRN

Thank you, Jenny, and good morning, everyone, and welcome to our November trading update that covers our first ten months of trading. I'm Jim Fairbairn, CEO and with me as our CFO, Ben Fidler, and I'll cover some highlights and then we'll open up to questions.

JIM FAIRBAIRN

So in the four months since the half year, our organic revenue growth excluding surcharges was 0.2%. Year to date, that means that we are tracking at around 1% organic revenue growth excluding surcharges. Overall, we're very pleased with progress. And although growth was modest in the second half to date, there was growth. This result reflects the resilience of our business model and also the diversity of our end markets. Energy input costs continue to fall and the surcharge difference year to date is 20 million pounds, which is around a 50% reduction. And as you know, there is very much a mixed picture around markets. And that means that we're focused on managing what is in our control and especially keeping an agile cost base and aligning our capacity with demand. I'm really grateful for all the efforts by our teams on these aspects. Since the last update in July, I've spent further time travelling around the group, and it's even more apparent to me just how positive Specialist Technologies is. It's very much a highly differentiated business with premium margins and further growth prospects. It also continued to deliver, and organic revenue growth is 7% year to date. We also continue to invest in this area, for example in our HIP business we installed new capacity in the US in the summer at Greenville, SC to capture the ongoing growth in demand. Classical heat treatment revenues were lower in the four-month period by three-point 3% organic excluding surcharges, primarily driven by lower industrial activity. It's impressive to see the businesses ability to respond to challenging market conditions. And now turning to our end markets and aerospace and defence, while growth has moderated as we expected, it still remains very positive, up over 6% in the second half and energy up nearly 12% on tough comps. It's very good news that the Boeing strike has ended, although we expect it will be into next year for the congestion in the aerospace supply chain to reduce. And automotive was up half a percent year over year on the same comparison and industrial markets remain challenging, down over 6% in the same period. It's clear these markets will remain tough going in the next year. The Lake City acquisition is progressing well and two expectations. I visited that site in July and it's an excellent business and a great fit for the group. The share buyback has been executed as noted in a release this morning with it just over 75% of the £60 million complete. We've also announced a capital markets event on the 12th of December where the team and I will lay out our new strategy and activities into 2025 beyond. And with that, I will open up to questions.

OPERATOR

Thank you ladies and gentlemen, we will now begin the question-and-answer session. If you have a question, please press the star followed by the one on your touchtone phone. Questions will be taken in the order received. Should you wish to cancel your request, please press the star followed by the 2. If you are using a speakerphone, please lift the handset before pressing any keys. Once again, that is *1. If you wish to ask a question, your first question is from Andrew Simms from Berenberg. Your line is now open.

ANDREW SIMMS

Thanks for everyone. So just first question for me, just on aerospace defence, it would be great for if you could provide maybe a little bit of color or split between growth rates, between structures and engines that you saw at Q3, maybe how that's evolved obviously given them the challenges at Boeing and Airbus and I suppose. Also linked to that, how would you envision your business seeing a pickup in the structures side as and when sort of Boeing starts to starts upgrading its own production. How early would you start see that, be interested to know that. And secondly, just energy, obviously your point about growth on tough comps is noted that you just discuss some of the trends there, maybe where you're seeing some of that that growth comes from may either by region or sort of in market. That's great, thank you.

JIM FAIRBAIRN

Yeah, so I'll take that one. And mainly in the second half, we've seen a reduction in growth. It was mainly civil aerospace, reflecting supply chain rebalancing and some of the issues from Boeing, you know, that are in the supply chain. We still see these as, you know, temporary effects and obviously structural growth remains positive. I think on the engine side and the structure side, and we we're definitely seeing it on both sides. You know, the good thing about engines is that we've still got good aftermarket sales and that's obviously, offsetting some, for example, some of the leap headwinds that we're seeing. And I think on the structure side, I mean, it's definitely very variable by customer. You know, some of our customers are reading the demand signals very differently, and they're making their own assessment around inventory levels. So, I think we expect, you know, in the in the near term that these headwinds will reduce. But I think that's really all we would say going forward. I think on energy, we've had some good, very good wins, in the Middle East and also industrial gas turbines in North America. And we see that remaining strong. Oil and gas by nature can be lumpy. We've still got a lot of pipeline but there is a lumpiness, to part of our energy business going forward. I think it will still remain positive but comparisons, you know, will inevitably become tougher.

ANDREW SIMMS

Great. Many thanks.

OPERATOR

Thank you. Your next question is from Andrew Douglas from Jefferies. Your line is now open.

ANDREW DOUGLAS

Good morning guys. Two questions for me please. Can you talk through the performance in automotive? I think relative to a light vehicle production market of -4 your performance is very good. Can you just talk through what's driving that market outperformance maybe across the regions if you if you can? And then secondly, a number of your industrial peers are talking about costs going back into the business next year. Am I right in thinking that for body coats that will be largely dependent on the top line as opposed to any kind of more structural costs going back into the business? You've done a good job on costs so far this year. Just wondering how that goes or how that looks as we go into next year.

JIM FAIRBAIRN

Yeah. I mean, in automotive, you're right. We're actually very pleased with the progress. You know, we've had strong growth in three regions and in China, Eastern Europe and

Mexico. A couple of reasons for that. I think you'll remember at the half year we talked about targeting specific OEM's, especially in China, and we'll be seeing the benefits of, you know, further supply chain mitigation and some new contract wins. So, I think I think that's, you know, created, the outperformance. There are still some challenges, especially in North America, but we're really pleased with the growth. I think on costs going back in next year, we very much were pleased with our approach to try and keep an agile cost base and keep the levers that allow us to breathe with the level of actual business. And I think that that is a that's one of the hallmarks, you know, of the Bodycote operating model and I think we've executed on it, especially in the second half very well. We manage costs, and you know, we haven't cut into any of the muscle of the business, OK, which I think is actually very important. So, all the variability and costs will be down to how the top line is playing out and how we see the top line playing out as you I think you said in your question. So, I think we're very much in a situation where we will, as business comes back, be in a really good position to take advantage of that.

ANDREW DOUGLAS

Thanks. and one follow up if I may. In terms of the variability month by month as we've gone through the second-half, have you seen much variability compared to your forecasts or has it just been a kind of challenging market in all four months?

JIM FAIRBAIRN

Yeah, I mean, I think we definitely saw some challenging months, you know, over the summer but it's certainly stabilized the last month or two. That's our current view. We feel like we have stabilised at a low level, you know, especially in industrial and auto. We feel as though we're stabilized at the moment at this low level, we don't see any variation from that going forward. So, I think, that's a positive if we can manage our costs, because then I think, I think that's, that's a good thing for us.

ANDREW DOUGLAS

OK. Thanks very much.

OPERATOR

Thank you. Once again. That is star one should you wish to ask a question. And your next question is from Stephan Klepp from HSBC. Your line is open.

STEPHAN KLEPP

Yeah. Hi. Good morning. Altogether, I have 3 questions. So, the first one is the structural growth and specialist technologies. I wondered if it's more at hand in hand with the outperformance of aerospace and defense and the oil and gas markets. And should we rather take it that with that positioning you can shield off the rather volume driven classical heat treatment where obviously volumes and markets are more dependent? Second question is the upcoming Capital Markets Day. So, in your July update you talked about footprint optimization, medium term target and reduction of complexity. Is there anything else since July that you found in your travels through the site etc, that is pressing for the capital markets say that we should expect. And last but not least you share buyback is over, cash generation is good. So, looking into 2025, is there more scope for more share buybacks? And if so, when would you be thinking about that aloud?

JIM FAIRBAIRN

So I'll take the first 2 and then pass to Ben. Thanks for the questions. So, specialist technologies, as I've travelled round, you know, I've seen all the technologies, S3P, HIP, surface treatment, and it's, it's just wonderful. And you're right, you know it's in the high end processes mainly aerospace, you know, automotive, I mean the real key processes. One of the neat things about that businesses is that we're continually adding in, you know, capacity and also our commercial efforts really focus on increasing the amount of applications that we serve and increasing our addressable market. So, I think so very much it's a cause type business rather than an effect type business. And you know, the teams are continually focused on actually continuing to increase the addressable market and also take on new kind of applications. I think the second thing around the capital markets day, you did actually mention what I talked about in the half year about the footprint, driving operational excellence, looking at growth, and simplifying reporting. As we think about our capital markets day, which is only in a few weeks, you know, these are very much front of mind. And I think everything that I said at the half year, you know, has been born out in all of my further travels, I've travelled everywhere around the group, I've seen every technology; the passion is there, and I think it's really all about evolution, at pace. You know, as we think about and what we're going to say at the Capital Markets day, there's no new information other than, it backs up everything that that I said at the half year.

STEPHAN KLEPP

Cool thank you.

BEN FIDLER

Should I pick up the one on the buyback and the capital allocation? So yes, I mean, look, we're about £46 million complete on the £60 million share buyback at this point. So still got something left to go. Around capital allocation, as we've said in the past, Stephan, we will very much retain our balanced approach to that with an eye also on the level of balance sheet leverage and what is appropriate for the business at any given point of our end market cycles. But it'll be balanced across the usual, different areas of deployment from organic investment, which we're committed to drive improvement in our existing operations as well as expanding particularly our specialist technology areas. The dividend, and we're proud of the dividend track record the business has. That's something that we will remain absolutely committed to. M&A, as and when appropriate, when attractive enough targets come along, as you saw as act on the Lake City acquisition earlier this year, which we're very pleased with. And obviously, looking at potential scope for additional returns to maintain the balance. And depending upon where we're at in the first three elements I've just run through around organic investment in particular and M&A, it's probably a bit premature at this stage with probably 3 months or so of the current buyback left to be commenting on what happens thereafter. It's something that we maintain a keen eye on. We'll take a view on in light of other sources of deployment and we'll communicate when appropriate for you guys.

STEPHAN KLEPP

Cheers, thank you.

OPERATOR

Thank you. Once again, please press *1 should you wish to ask a question. Your next question is from Harry Philips, Peel Hunt. Your line is now open.

HARRY PHILIPS

Yeah. Good morning, everyone. Sorry, three questions. The 1st is just on HIP particularly, it's been a lot of chat that sort of casting forgings, etc, all beginning to get a little better. And I was just wondering how that is helping your hip utilization rates and prospects there. ? The second is just on the growth CapEx, just obviously it's a variable and hard to sort of pinpoint into exact periods, but just thinking around growth CapEx, I guess that might be a theme for next month as well. And then lastly, I've got cut out of the call for a couple of minutes. Maybe you mentioned it, but just on medical particularly, just how long do you have any insight as to how long that sort of softness might be sustained for? It's interesting you describe it as temporary softness, but obviously it's been softer for a while now.

BEN FIDLER

Yeah. Should I pick up on those? And then Jim, do feel free to add anything. So yes, look on HIP, actually HIP has seen a pretty good performance both year to date and in the second-half. It has been impacted, and we started to see some impact as doesn't surprise us over the summer from some of the early stage aerospace supply chain rebalancing effects. But nonetheless, even looking through that, we're actually quite pleased with the performance of HIP. As Jim said in his introductory remarks, a new HIP operation came on stream this year for us, which is necessary for good reasons because we're, you know, as we fly forward starting to run short of capacity. So, we continue to invest in that area there. So, I think on HIP I would say, look, we're, we're pleased with the progress, pleased with what the business has been delivering as well as driving some operational improvements in some of our US HIP areas for this year. On growth CapEx, it wasn't entirely clear on, on the question, if I'm honest, but look at growth CapEx, what do you specifically want us to address?

HARRY PHILIPS

The, the debt number looks really good and, and just trying to think about where you might end up for the year end. And here we are with just two months left for the year where growth CapEx might end up being. And then I guess, as I said, debate more for next month or more philosophical debate around growth CapEx and the size of it going forward, let's say maybe that waits for next month primarily.

BEN FIDLER

Yeah, OK. Well, look, our growth CapEx last year was around what about 25 million or so of expansionary CapEx last year. I would expect for this year to be a sort of in the ballpark of broadly similar number for this year. We're not wedded to an absolute number per se for that. What matters for us and what we look at very rigorously and carefully is the opportunity pipeline for us to invest and the business case of each of those individual opportunities. You know, we remain very committed to having, as you've heard us talk in the past, a 20% IRR threshold on new investments. Thankfully, there's usually a lot of opportunities that are capable of delivering that, particularly in our specialist technology areas, which is predominantly where I would expect you should see expansionary CapEx focused. If we think about expansionary CapEx and the state of the balance sheet, of course we will be balanced over where we deploy our capital across - as I answered with Stephan's question - across all of the different legs of capital deployment. It won't just be expansionary CapEx that is the piece that we push on as far as where we may end for the year. You saw the net debt position at the end of the 10 month period of £66 million. Of course, remember the dividend which was about £13 million, it was paid in early November and you need to take that into consideration there as you fly forward. And then yeah, your own view in terms of what you think the free cash generation of the business is going to be for the last two months of the year. I'll leave you to do your math there, Harry. Finally on medical. Look, the destocking which we've seen continue to impact through the course of this year, it wasn't any worse in the second half. And if anything, the medical a medical market performance was modestly better second-half than first half. By better I'm meaning still negative, but just less negative than it was in the first half. So, it's still too early I think to say, Yep, you know destocking's finished, but at some point, it has to finish. And certainly, you look at all of the long-term structural growth dynamics in the medical orthopedic devices market, which accounts for a very large part of our medical exposure, and you know aging population, growing middle class. All of those dynamics point to a market that will see continued mid-single digit type of growth which is what we would expect once we get through this current destocking cycle. Also do remember for us you've got some very tough year on year coms with medical growth for 2023 having been in the mid 20%. So there's also a degree of that in this year's numbers.

HARRY PHILIPS

Fabulous. Thanks, Ben.

OPERATOR

Thank you. There are no further questions at this time. Please proceed.

JIM FAIRBAIRN

OK. Well, thanks everyone for joining the call and we look forward to seeing you all at the Capital Markets Day.

OPERATOR

Thank you. Ladies and gentlemen, the conference has now ended. Thank you all for joining and we all disconnect their lines.