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De Nora Q3 2022 Q&A Session

Wednesday, 10th November 2022

Questions and Answers

Operator: Thank you. As a reminder, if you would like to ask a question or make a contribution on today's call, please press star one on your telephone keypad. We will take the first question from line Alexander Virgo from Bank of America. The line is open now. Please go ahead.

Alexander Virgo (Bank of America): Thanks very much, and good afternoon to everybody. I trust you're well. I wondered if we could dig into water tech a little bit, please. Firstly, a couple of clarifications. So would it be fair to assume that the increase in revenue in pool tech takes that business to closer to 55% of revenue on a trailing 12-month basis? And the 70% of growth that you talk to or refer to as price. That's divisional level, is it? Or is that at pool tech? Those are the first sort of clarification questions. And then I have a couple of follow ups on trends, if I may.

Matteo Lodrini: Yes. It basically is on pool and the effect on the growth on pools is mostly on price.

Alexander Virgo: Okay. So the 70-odd-percent - €70 million-odd increase is mostly price as well?

Matteo Lodrini: Yes.

Paolo Dellachà: 70% is price.

Matteo Lodrini: Yes.

Alexander Virgo: 70% of the €72 million is price.

Matteo Lodrini: Yes.

Alexander Virgo: Yeah. Okay, that's fine. Thank you. Sorry. Thank you. I just wanted to make sure I understand it correctly. And then, in terms of the dynamics here, I guess the backlog that you have at the moment you called out how much that covers of FY 2022 and the balance of the year. So I understand that.

My question is really about the sort of visibility you have with respect to the distributors and the destocking that you referred to. It sounds very – or particularly severe if I listen to the likes of PoolCorp [?], or some of the other companies in this space. And I'm just wondering how you see that playing out and affecting your business as you move forward into 2023? And in particular, as you comment that your inventory levels in division are higher than you expected them to be? Does that mean that we need to think about under-absorption of costs? As presumably, you'll have to under-produce to manage that inventory down. Thank you.

Matteo Lodrini: Yeah. Thank you for the question. I think it's very important. I will answer immediately to the under-assumption. We don't see any under-absorption. The way we see the pool business is after a super first half year, we noticed since August a slowdown in the orders. And you see in the quarter three the pace of growth in revenue, which is lower than the previous quarter.

What do we see in terms of visibility for quarter four is that the slowdown will continue. And my comment on the destocking lower than what we expect is because of that, because the market is clearly in difficult to grow. But the way we see first of all on a full year basis is together

an extremely positive growth that we can achieve in terms of revenues associated with higher profitability.

Now, we have not yet complete the '23 budgeting, but I will be very pleased to give you the outlook. The outlook for pool business based on what we see and hear from our customer and – is that the low sales volume that we are seeing in quarter three will probably persist in quarter one. Meanwhile, we expect the improvement overall in the course of the remaining quarter with an acceleration in the second part of the year.

If I look broadly about how we project the growth of the pool business in this year starting from '22 and looking beyond '22, meaning in '23, I see that from '21 to '23, still in our expectation we were achieve the double-digit growth that we gave in our mid-term guidance. And this will consider '22, especially first half for the year a quite an exceptional condition of the market, which was driven by staycation, COVID effect, and a huge inflationary on noble metals.

So, of course, the slowdown in the last quarter is consider. But we have a moderate positive view on the – on '23. And we are confident that our guidance – midterm guidance in terms of growth compared to '21 will be maintained and achieved.

Alexander Virgo: That's very, very clear. Thank you very much. Final clarification one on just that before I get back in the queue is, can you give us an indication of what you see as new construction versus aftermarket in the pool business in terms of demand?

Paolo Dellachà: Yeah, that's actually one of the advantages of De Nora, right? Because, historically, even though you can imagine that by serving everybody, the pool makers are not so keen in disclosing us precise numbers about what they do in new installations versus what they do in replacement and service.

But in general, our assumption that has been matured over the years was that 70% of our revenues were related to replacement, so to aftersales. Of course, we account everything new, just because of what I said, meaning that we are not able to have precise numbers dedicated with the – precise allocation of what is new, what is aftersales, so everything is accounted as new. But that's because we have millions of pools, as is install base. This trend will continue.

So thanks to the impressive new install base that has been done in 2021 and 2022, we are going to enjoy a huge portion, again of our growing revenues in the pools coming from the replacement.

Matteo Lodrini: And if I may add on pool, so we closed the cycle. In pools, quarter three is showing a good price overall in terms of margins. So our margins are pretty strong despite the slowdown, which allowed me to say that even in – for the outlook '23, we are confident that the growth that we want – we expect to achieve will be associated with good profitability for pools, thanks to the contract indexation with our pool customers.

Alexander Virgo: Very good. Thank you, gentlemen.

Paolo Dellachà: Welcome.

Operator: Thank you very much. We will take the next question from line Chris Leonard. The line is open now. Please go ahead.

Christopher Leonard (Credit Suisse): Hi there. Thanks for taking a few questions. If I could actually just follow on, on the pool business or at least on water technologies and just get a bit

of clarification there. So I may be wrong on this. But I think that the Q3 EBITDA margin was around 16%. So just to get your level of comfort, looking into Q4 to see that margin increase to enable you to hit that sort of long-term or your guidance level at around 20% EBITDA margin for the year, which you've given. So if you could just start with that one, please?

Matteo Lodrini: Yes, I can confirm you – I can confirm the 60%. But I want to absolutely confirm our confidence for our guidance to the year-end to achieve 20%.

Christopher Leonard: And is there – I mean, is there anything in the mix that's changing there that you could help us with just to speak to that difference in the specific?

Matteo Lodrini: I mean, it's – the contribution also from the WT systems, meaning the WT, quarter four is a key contributor for the profitability. I just want to record to everyone that in the Water System business, almost 40% of the results are achieved in the last quarter. And that's the reason why we expect good result in quarter four on this specific aspect and our confidence in achieving our guidance for the full year on the water segment.

Christopher Leonard: Great. And then just to be clear when you speak to 2023, the outlook, confident there in further growth associated with good profitability. I mean, what do we class as good profitability? Is that the exit rate in Q4 2022 at like a 20% EBITDA margin? Or are we looking more at where we've just been in Q3 at 16%? Like, where do you see that kind of range or if you can give any early indication on that?

Matteo Lodrini: Let me say that, first of all, if you ask me an outlook for the whole WT for '23, especially what we have seen in the pool business as potential slowdown in quarter one and pick up in the second part of the year would be counterbalanced by a significant growth in volume in the WT system. And this is evidenced by our backlog. The backlog in the Water System platform is a record high. And that is a strong sign of a healthy order intake, which give us a clear indication and confidence that the business will continue to grow in the Water System at the higher pace.

And this will be associated with the profitability that we expect to be relatively positive also for '23. I'm not expecting a major change in the profitability outcome. But we have to acknowledge that the '23 is in a recessionary environment. So we have a good confidence to maintain the level of this year or something close to. But again, it's just an outlook. It's not our guidance, because it's too early for us. We are not complete our process of budgeting '23 yet.

Christopher Leonard: Sure. Super clear. Thank you for that. And just quickly turning to the Energy Transition segment and green hydrogen, if we can. Order momentum there is looking good. Can you just speak to where you guys see the average order size going in terms of megawatts? And then I think you also commented on the improvement that you think you'll see in Q4, and I think you mentioned a doubling of revenue. And just to be clear, was that versus Q3 or was that versus the nine months to-date?

Matteo Lodrini: Sure. I can be precise. Our expectation for year-end considering the production schedule is to achieve between €40 million to €50 million in revenues. And so considering what we have been already factor until September, you can see that there is a significant one part, which is by the way, what Paolo was just mentioning before just the – more the ordinary course of production that you will see for '23. So, we are very confident for that, and I hope that we will continue in this space of delivery.

In terms of profitability for a ETR, we – as I said, we are anticipating the good results that we were expecting in '23. Our gross margin is improved and higher than what was at the beginning our expectation and the guidance that we gave to the market. And this proves, to be honest, that we have a very solid cost structure and knowledge of the price. And in our expectation this will give us even further upside in specific profitability for '23 in the energy transition if we consider the relative performance in percentage.

Christopher Leonard: Perfect. That's it for me. Thank you. I'll jump back in the queue. Thanks.

Matteo Lodrini: Welcome.

Operator: As a reminder, if you would like to ask a question, please press star one on your telephone keypad. Thank you. We will take our next question from line Alexander Virgo from Bank of America. The line is open now. Please go ahead.

Alexander Virgo: Thanks very much. I thought I might come back on energy transition, if I may. Just thinking about how you envisage the phasing of business over the next – on the revenue side, I guess, on the next few quarters. Your comments, though, I guess on October, backlog of close €800 implies €150 million, I think, order intake in the last five or six weeks. So I'm just wondering where that is coming from and whether or not the energy transition side of things is something we need to think about as being a little bit more 2023 weighted from here.

Paolo Dellachà: The part of the order income of October is, of course, related to Energy Transition, yes. It is the partial transformation of those so-called secured orders that are transformed into backlog for us. And capacity-wise, production-wise, we are in a ramp up mode. So the – what we anticipate that in the last quarter we're going to make a significant growth, is absolutely the result of this ramp up process.

So backlog is sustaining us beyond 2023. And we are going to be busy in 2024 as well, thanks to these orders that we have either in a backlog or has been already secured by our partners.

On the other side, the ramp up phase is growing every month to come into a level in December that should be maintained on a monthly basis all across 2023. And that's why I said that 2023 is going to be the first year for De Nora, where we are going to work on a gigawatt scale, production-wise, which is a very important step fully covered. So it's just a matter of us to deliver, execute and deliver, and then of course is one of the important steps you are having in growing our capacities to the level that we expect beyond 2023 with the expansion of Asia and all the activities we have in place running in parallel right now.

Alexander Virgo: Very helpful. Thank you.

Paolo Dellachà: You're welcome.

Operator: Thank you. We will take the next question from line, Isacco Brambilla from Mediobanca. The line is open now. Please go ahead.

Isacco Brambilla (Mediobanca): Hi. Good afternoon, everybody. One quick question from my side on electrode technologies. If I got correctly, your information on volumes and prices in the division growth in the third quarter was almost exclusively driven by volumes. So can you

please confirm this and also help us understand how we should look at 2023 for this division, given such strong trends in volumes?

Matteo Lodrini: Well, it was not only volumes. It was also price. We gave our commentary about the 60/40 split between volume and price. The growth is also typical characteristic of De Nora being a resilient company and the aftermarket is one of the back of our consistent revenue stream across the quarters.

In our core business, Electrode core business, the demand seems extremely positive and strong. You see quarter-by-quarter continues heading up in terms of revenues. Backlog is growing. It's, no doubt, in a very healthy condition. And this is also something that we try to present to the investor in terms of anti-cyclicality of De Nora. And this will continue in our expectation in the course of the next quarters. And also the outlook for '23, If I may add this comment for core electrode is in our view positive and supported by the increased backlog.

Isacco Brambilla: Okay, thank you.

Operator: Thank you. We will take the next question from line Chris Leonard. The line is open now. Please go ahead.

Christopher Leonard: Yeah. Hi guys. Jump back into the queue, please. Sorry, back into the question stream, following up on electrodes. I mean, the margin was very good in Q3 and sort of I think 26%. So looking into Q4, it doesn't look very difficult for you guys to achieve that sort of 25% potential EBITDA margin going – should we expect that now with greater demand coming through for upgrades as Chlor-alkali systems go to the newer membrane technology. Do you think you can sustain that level of margin into 2023 and beyond to just to get a feel for where we should benchmark the – that business after coming is? Thanks.

Matteo Lodrini: Yes. In terms of EBITDA level and profitability level, the answer is yes, we see stability. We have to consider that there is a – there has been also a big swing in noble metals. And quarter by quarter, we are going to release our inventory. So there will be some impact in the profitability, if I look at the quarter by quarter basis.

But if I take my full year, I again can confirm overall a strong price levers from our side and stability in terms of overall profitability. So we are confident heading towards '23 in terms of route, let's say profitability in the core business will be maintained stable. We have also to consider that in this business, we have a leadership position. And we have also a geographical presence that we can maintain very good control over our market customers and pricing.

Christopher Leonard: Thank you. And coming back to the Energy Transition segment as well, and just trying to get a feel for that run rate of production. I think on the call you mentioned 250 megawatts of production in this year. And then, probably spoke to going above a gigawatt next year. Should we see that as delivered volumes to customers for energy transition electrodes? And sort of alongside that different question, but what sort of footprint will you be running with in terms of manufacturing capacity? And do you have that available today, a gigawatt for 2023 production capacity? And just talk us through where you are today and where you will be by the end of '23? Thanks.

Paolo Dellachà: We are – yes, we do have what we need to fulfil our production scheduling for 2023. In the meanwhile, started already this year and going very much ahead during the course of 2023 we are increasing the production – the existing production capacity in Germany,

where a big portion of this products is currently made. We are in parallel running the expansion with the specific technologies for alkali water electrolysis, both in China and in Japan at the same time.

And so that will give us, by the end of '23 beginning of '24, additional capacity to be able to ramp up over an additional quantum leap in 2024 our production schedule and beyond, of course.

Christopher Leonard: Yeah. No, thank you for that. And just to go back to an earlier question as well, the average order size you guys are seeing, I mean, is there any indication you can give for megawatt sizes of maybe in the US or across Europe? What you see right now and where you think it will be next year?

Paolo Dellachà: Yeah, the pipeline of projects that through our partners, in particular, our joint venture we are serving the following is impressive. It's all across the world, I have to say. It's not only Europe, it's in the States, in South America, in Middle East, in Asia, in Australia. So there is a very, very good point in saying that we are in connection and driving projects all across the world. For sure, there are huge expectation from United States, thanks to the Inflation Reduction Act. But we don't expect it tomorrow.

I mean, the two orders we have in full execution right now for the United States, they happened before the Inflation Reduction Act because of course there are a number of activities going on in green ammonia, in green hydrogen for mobility and other applications.

Will the IRA will speed up and make a revolution in the country? Absolutely, yes. Will it take some time to be deployed in projects? Yes, as well.

Going to the size, I can tell you that the selected projects that are the most credible ones that, for example, our JV is working or not, they are a very, very important number despite it's just a selection just to be able to focus the people and to concentrate the people on the most credible one. But we have to say that because of our nature, because of the strong skills we have in delivering large scale electrolysis plants, first for Chlor-alkali, now for green hydrogen, I have to say that the average size of this project is pretty huge. We're talking about hundreds of megawatts each as average. So going up to the gigawatt scale in few cases. So that is our nature, our DNA, and that's what the market is recognising us.

Christopher Leonard: Thank you for those answers. I'll jump back into the queue. Thank you, guys.

Paolo Dellachà: Thank you.

Operator: It appears there's no further question at this time. Thank you.

Matteo Lodrini: Okay, thank you to everyone.

Paolo Dellachà: Thank you, everybody. Have a great day.

Matteo Lodrini: Bye.

Operator: Thank you for joining today's call. You may now disconnect.

[END OF TRANSCRIPT]