COLT CZGROUP

<u>Q1 2022 Analyst conference call Colt CZ Group SE</u>

Ladies and Gentlemen,

Welcome at the analyst conference call in connection with the announcement of the first quarter 2022 financial results of Colt CZ Group. Let me welcome today´s speakers on the call. It's Mr. Jan Drahota, CEO and Chairman of the Board of Directors. Hello, Jan.

Jan Drahota, CEO:

Morning, everybody.

Klára Šípová, IR:

And Mr. David Aguilar, who is the member of the board, and also our chairman of the board of the North America. Hello, David. Good morning.

Today, we will discuss the presentation which will send to you and it's also available on our website. After the presentation, you will have the opportunity to ask questions in the Q&A session. The call is being recorded. And I would like to ask you to stay muted during the call. And now I'm going to hand it over to Jan to start the discussion.

Jan Drahota, CEO:

So once again, good morning to everybody from my side. You know, it's already a good habit that we introduced to different members of the senior leadership of the group. Today you have the opportunity, David Aguilar is with us in Prague. So, we thought that it would be good that he joins us for this call. He didn't have to wake up as early as Dennis last time.

David Aquilar:

And I appreciate that.

Jan Drahota, CEO:

Yes. And David has been with us for some time. And now he's chairing NA board. And it's very appropriate or very good timing. Because, as you know, we have been undertaking the integration of the US businesses of CZ and Colt. And David has a real long experience with law enforcement, he has served more than 35 years for the US Customs and Border Protection. And what is important that as a chief for Border Patrol, and then deputy commissioner and Acting Commissioner of Customs and Border Protection, David was ranking officer during the integration of the 3 legacy agencies into the custom and border protection, which is currently the largest federal law enforcement agency in the US. So, he's got good experience with mergers, integrations in maybe in a different environment. But nevertheless, the processes and what it takes to let´s say align cultures and values. So, we like it. And he's from the chairman of the board of the US board position a good partner to the executive team in the US headed by Dennis, you know, to proceed with the integration. But now, so once again, welcome, David.

David Aquilar:

Good to be here.

Jan Drahota, CEO:

So once again. But let's now start the presentation if I may. So, if you go to next slide, please.

So, as you already saw in our press release, and maybe you had a chance to go through the presentation, the q1 of 2022 was a strong one in terms of comparison versus q1 2021. Obviously, the big push and kick is in the form of full consolidation of Colt. So, this year 2022 will be the first year where we will have full consolidation of the two businesses together. If we comment, you know selected KPIs, revenues up 75% to 3.5. bn CZK, EBITDA up under 20% to 1,955 mm CZK, adjusted net profit 30% almost up to 632 million CZK and adjusted EPS 125% to 18.5 CZK as per share. What I would say here, and maybe we'll discuss that later, you'll see that the adjustments will lead to the profit, no adjustments to EBITDA, because we believe that everything what is there should be there and we didn't add up any cost like incurred in the q1. If you go to next slide.

This gives you a good idea. You know how we did in terms of numbers of units sold as well and geographical split. First of all, you see that the number of units sold grew slower, I would say it's 60% of the growth of the revenues than the revenue. So, we grew revenues faster than the number of units produced which tells you something about the products, we sold more higher value, higher price, higher value items. And you see it also in these graphs. On the fact that number of units of long guns sold went up by almost 60%, whereas number of shotguns, pistols, revolvers went up only by 30%. So, we outgrew in the more higher value items, and it's why they went up mor than 75%, compared with the lower growth of units sold. As far as the geographical split is concerned, you see on this graph on this chart, or on this page that US is the most important market, but I would say that the part of it is nicely split around the world, we have a strong sales in Asia, strong sales in Europe, strong sales in Canada, Canada became a one of the key markets after acquisition of Colt and having Colt Canada as a sole supplier of small arms to Canadian army.

And the Czech Republic, obviously, when we started to fill in under the framework contract, you see that the only region which is I would say, much lower, or much lower than last year is Africa, because as we already discussed several times, the it's more a region of let's say, of the larger contracts, which need some lead time. So, we didn't have anything big in q1.

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I would say that first of all, we know we already did discuss the key KPIs, revenues and EBITDA. So, I will not comment more on that one. What the message from this slide should be, first of all, that we confirm the guidance for the full year. And the first message, even though I would say that the environment is challenging on both fronts, you know, I mean, it's challenging in terms of our ability to manage costs, because obviously, there are cost pressures in the global economy, is challenging in our ability and it is challenging our ability to switch between production of different products, because the demand for different products is let's say, swinging. So, we have to adjust our ability and we are adjusting our product mix produced. So, this is also the mandate. And overall, we are living in unprecedented times, you know, we you know that there is ongoing war in Ukraine, which obviously has provoked or means that the value of what we are providing to our customer security has gone up, but at the same time, it brought a lot of uncertainty. So, message, we confirm the recall from the guidance on both revenue and EBITDA.

But it is definitely hard work to earn money, you know, I mean, these days. As far as the margin concerns here, you see that there is a swing to higher margin than what we are used to, I mean, the EBITDA margin is twenty, almost 27%. My comment here is that it is not a trend that we will have 27 EBITDA margin. For us, we like everything what is above 20, if that's what you have been saying. And obviously, you know, the long term I would say sustainable has to be above 20. And is probably in range of 20 to 23,24. But this is I would say that what we believe is the long-term sustainable margin. If we go next slide, net profit, I told you that the only KPI we did adjust this time was net profit, and the only adjustment came from the earnout adjustment because as you know, because the acquisition of Colt was successful, or has been successful. We owed the sellers of Colt pro rata earn-out, they will receive around more than 300,000 shares for the year 2021. So, we are evaluating the full potential and now versus the p&l. That is the IFRS rule. And because of the 87 million CZK in q1, once again, this is the revaluation of this of this contingent obligation. So, we do believe that it makes sense to adjust for that and that is why we can say that net profit is true, you know, as a repeatable net profit in our logic is 632 million CZK. So, more than 129% up versus last year, and same applies for profit per share. If you go to next slide.

I would say here on this slide I would comment CAPEX. So, nothing changed in terms of our view on capex, we still believe that this year, capex will be at or will be approaching 5%. So, I mean, approaching 5%, as we gave you guidance with the full year results of 2021. For us, definitely, what we are working on is several initiatives, both in Czech Republic and the US. And it is about, you know, increasing capacity for products or parts, which we believe makes sense. And also, in the US, we are working on some insourcing projects because as you know, Colt has been outsourcing a lot of its production to increase the profitability, especially on products, which we have, let's say long back orders, and we cannot satisfy the demand. So, we know that it's, I would say, kind of a safe bet or conservative bet to insource those items, obviously, a part of the cash flow, the nature of the business was so strong businesses, I mean, so it's good and I will comment for the quarter this quarterly swing. So, strong q1 and CAPEX we keep where we are, I mean, first quarter was lower capex and then expected then FY expectation, but I will say that this will even out during the course of the year because it's only Q 1.

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Debt structure I think that there is not much new which I would commend here for those who saw the presentation last time they know first of all, we did issue in q1 the bonds to refinance the bonds of CZUB successfully. So, we have now only two bonds outstanding 2027 2029 maturity, I would say that happy you know, we also communicated to you guys how we are hedging our exposure both on forex and interest rate and we know and you see that our net debt to EBITDA is relatively low, it will change a bit with the payment of the dividend, but it will still go you know, to basically to levels where it was at the end of the last year. And how we look at it is that it gives us first of all, you know we are conservative so we are not the financial engineers who would like to play with the leverage, you know, to test what the market and can handle but most importantly, and I think this is important to say it gives us flexibility for the potential m&a transactions. And even though I cannot disclose anything, you know, we are working on several potential deals, and hopefully, we will be able to give you more flavor on those rather sooner or later. But at this stage, we obviously cannot discuss and I think so. So, it gives we believe that this gives us great flexibility to execute, if you wish. And if you see something which is which makes sense for us. If we go to the next slide.

That it. So today was short, it contained everything we wanted to tell you. And now you know I think that the floor is yours to ask questions. Don't hesitate to ask Honza Zajíc. Because Honza is with us as well. Anything specific that you feel is of your interest. Okay, thank you.

Klára Šípová, IR:

Thank you.

So, if you would like to ask question, please raise your hand on the screen, or send an email via chat or send a question via email or speak to the microphone.

And the first question goes to Atinc Ozkan, Wood & Company.

Atinc Ozkan, Wood&Co.:

Thank you, Clara. Good morning. All. I hope you can hear me clearly. So, my first question is regarding prices.

It was very clear that in the first quarter, your revenue growth outpaced your sales volume growth. And sales mix has changed in favor of long guns.

Can you elaborate? What happened with your pricing dynamics? Were you able to increase pricing again in the first quarter? I remember you did some in the fourth quarter.

That's question number one. And my second question is Has there been any development regarding this dividend policy change potentially if you are going to make it more predictable. When should we expect that change to will take place? Thank you.

Jan Drahota, CEO:

Okay, thank you for those two questions. Pricing, as far as pricing is concerned, the biggest sale and the major move on both sides of Atlantic was at the end of last year. So, obviously we are following or we are watching the developments and adjusting prices, you know, I would say continuously but the big move on the prices was at the beginning of this year or at the end of last year. So, no changes, you know, on a weekly basis to pricing, you know, increasing the pricing. So that's the answer to the first question. For dividends, we know that we owe you, you guys the clear dividend policy specification, we did discuss that on the board. And I believe that we will have a document available for you guys rather sooner or later. But because more time, you know, just to formalize it there because it is not formalized yet. It is not really in the final stage where but you will get it, I promise that it will be available before the end of Q 3. So, I think that, you know, it would be great if it was before holidays. But I cannot I do not want to overcommit. But I think that before the end of q3 will be available, better guidance for dividend policy going forward.

Atinc Ozkan, Wood&Co.:

Thank you. If I may ask just a very short follow up. Is there any timeline when we should expect the start of production at Colt facilities of Czech design products? I think this is what you are? This is part of your strategy to move some of the production from Uherský Brod to Colt. Is there any specific timeline when this this is going to begin?

Jan Drahota, CEO:

We have not communicated you know, clearly to the market, or we will I mean the timing, but this year, it will not be happening this year. I mean, it will be happening this year on more models.

Atinc Ozkan, Wood&Co.:

That is clear enough. Thank you very much.

Klára Šípová, IR:

Yes, question goes to Mrs. Vaněčková from ČSOB asset management. Go ahead, please.

Vaněčková, ČSOB AM:

Thank you. Hello, everybody. I would like to ask you, if you're already thinking about some external credit rating work. If not, when is the moment you will start to think about it? Thank you very much.

Jan Drahota, CEO:

Great question. And I will say this way, for us, we still have not needed it because the Czech market was receptive to our story and was receptive to our credit profile. So, we didn't need it. We did not really, we had several discussions with rating agencies. And as you know, in aerospace and defense to not to be punished for size, you need to have currently probably size of two billion rather than one. So, I would say that unless we do a substantial transaction within the next, you know, 24 months, I don't expect us to go for rating. I think that we will have sooner ESG rating than credit rating. That is the first thing I think that we will sooner apply for ESG rating than credit rating. But obviously, I would not exclude anything because you know, dynamics can change and we can read that it will make sense. But as I said, you know, that is for in our size of six - 7 million dollars or three hundred million euro, if you would be still penalized for size because of the credit methodology of the rating agencies. So, we didn't do that, because our credit metrics as such is I would say in A range and the only penalization would be for the size.

Klára Šípová, IR:

Very good. Next question comes from Mr. Raška from FIO banka, please go ahead.

Jan Raška, FIO:

Hello, can you hear me? Good morning. I would like to ask you for interest rates if I understand correctly. In March, you mentioned that you are hedging the part of your debt. If I understand correctly, about 50% of your gross debt is hedged. You also mentioned that the average interest rate is 2.7%. So, if I understand correctly, that this rate is related to hedged part of debt and the rest of your debt is exposed to market conditions. It means six months PRIBOR plus margin. Is it right? This idea? Thank you.

Jan Drahota, CEO:

No, not totally. We disclosed, I think at the end of last year that we had, can you please switch off the micro somebody? Because we have the big noise. But anyway, so we did disclose, and it is also in the annual report, we did disclose the amount is actually above or around 5 billion CZK, which is hedged. So, it's more than net debt. So, we are now hedged more than net debt. So obviously, you are right that the next part, which is around two billion, with less than 2 billion we are exposed to market rates, but at the same time, we have available or free cash. So, I will say this is offsetting each other, you know, at least partially. So hedged part is bigger than 50%. It is around 5 million. So, it's 70%. It is more than net debt, actually. And that's the rate I believe that we disclose it. I think a melted rate in Euro, dollar And Czech is around 2.8 percent all-in, together with credit spreads. So that's the message, but please revert to our presentation for 12 months results, there is the exact number.

Jan Raška, FIO:

Okay, thank you. Thank you. If I can yet enter, what is your expectation about interest expenses this year? My estimate is about 400 million CZK, maybe more than 400 million CZK. Is this right estimate?

Jan Drahota, CEO:

You know, net interest expense or interest expense?

Jan Raška, FIO:

Interest expense.

Jan Drahota, CEO:

Yes. But obviously, yes, but we look at it in the net basis right. So, it's a bit different view. I would say that we have not given guidance on that one. It's easy to calculate let me revert to you I mean; I don't have it in my hand. We are levels which I told you and then the fluctuation of the rates is offset by deposits but we can refer to you. Because net interest expense is lower.

Klára Šípová, IR:

If you have some additional questions, please raise your hand again. Or simply speak to the microphone if you are connected via phone, thank you.

No other questions. Maybe we will give the opportunity to the journalists from Reuters or Bloomberg if they would like to ask something if not, thank you very much.