Polestar

Q322 results webcast transcript

Thank you Operator. Hello everyone, my name is Bojana Flint, and I head up Polestar Investor Relations.

Let me cover a few housekeeping points, before handing over to Thomas Ingenlath, our CEO for his opening remarks followed by Johan Malmqvist, our CFO who will comment on our quarterly financial results in more detail. This will take about 15 minutes and we will then open the line for analyst questions. If we have some time left, we will take questions from the web, which I will read out.

Before handing the call over to Thomas, I would like to remind participants that many of our comments today will be considered forward-looking statements under US federal securities laws and are subject to numerous risks and uncertainties that may cause Polestar's actual results to differ materially from what has been communicated. Forward-looking statements made today are effective only as of today, and Polestar undertakes no obligation to update any of its forward-looking statements. For a discussion of some of the factors that could cause our actual results to differ, please review the Risk Factors section of our annual report on Form 20-F or our other recent filings with the SEC. You may also find more information on our forward-looking statements in our filings with the SEC or our investor update presentation and recent press releases which are posted on our investor relations website.

With that, I'd like to turn the call over to Thomas, please go ahead.

Yes, thank you Bojana. Hello everyone. Thank you for joining our first quarterly results call. I will start with some opening remarks and then pass on to Johan, to comment on our financial results and 2022 outlook.

Now, this is an amazing year for Polestar – full of major milestones. I am particularly proud of the phenomenal global premiere of Polestar 3 that we delivered in Copenhagen a few weeks ago, in front of hundreds of media, shareholders, and customers.

Polestar 3 is our first SUV, built for the electric age. It is full of fantastic features: Centralised computing with the NVIDIA DRIVE core computer, for example, running on software from Volvo Cars. Making it one of the safest cars and prepared for the future of highway piloting. Polestar 3 is a car that has been designed as a Polestar from start to finish. It defines the essence of our brand, in terms of design, luxury, and ambition.

Other milestones were, of course, our successful listing on New York NASDAQ in June.

A new global partnership with Hertz totalling 65,000 cars over five years. We moved fast here: already today you find in 7 countries in Europe and in the US and Canada a Polestar fleet with Hertz and we are continuing month after month to expand the offer of electric Polestars into the mobility on demand arena.

Last week, we announced a $1.6bn financing package from our major shareholders. We welcome their strong and continued support, especially when capital markets are volatile and unpredictable.

In the first 9 months of 2022, we delivered approximately 30,400 vehicles globally, up around 100% year on year. Our fourth quarter is expected to be our strongest on record yet and we are delivering against our 50,000 car's target. This is us meeting our annual sales targets for two years in a row – having also achieved our 2021 delivery target.

We will celebrate next week a major production milestone: 100,000 Polestar 2 vehicles out of the factory gate. This solidifies our position as one of two, global pure EV players already in mass production.

Our cars have been recognised with multiple awards – I am particularly proud that the Car Design Awards recognised Polestar with the prestigious Best Brand Design Language for 2022.

I would like to conclude with investment highlights that differentiate Polestar from others, and will enable us to deliver on our strategy:

One. Our well-defined growth strategy which we are capturing by: Operating in the fastest-growing car segments; having a rapidly expanding premium product portfolio to include 5 pure EV vehicles by 2026, and with a global footprint of 27 active markets today. Unlike most of our peers, our global ambitions are a reality, not an aspiration.

Two. The asset-light model that combines the best of both worlds. The agility of a start-up with the stability and manufacturing know-how from Volvo Cars and Geely. Importantly, this gives us access to production capacities across Asia, Europe and US - without having to build our own factories or find manufacturing partners.

Three. We have a digital-first, direct-to-consumer approach, that is complimented by an extensive network of retail sales and service points.

Four. Our core pillars of Design, Innovation and Sustainability coupled with our relentless focus and attention to detail. This includes avant-garde, pure Scandinavian design; performance orientated hardware technology; innovative software solutions and smart partnerships; our leading ambition to create a truly carbon neutral car by 2030.

Lastly, demand for Polestar 2 remains very strong. We would have easily exceeded our vehicle sales target were it not for Shanghai lockdown earlier in the year.

Initial reception and the demand for Polestar 3 is also incredible. Over eight hundred thousand of YouTube viewers watched the world premiere of Polestar 3 online. It has created website traffic for Polestar similar to the buzz that our extremely successful Superbowl campaign produced.

I want to reiterate, Polestar is a real car company. We are in production. We are putting cars on the road today. We are delivering on our ambitious growth plan.

Now, Johan, I would like to ask you to comment on our financial results.

Thank you Thomas, and Hello everyone, and as Thomas said, thank you for joining our first quarterly earnings call. I look forward to interacting with many of you in the future, and please continue to engage with Bojana and the IR team, who are always here to support. We are glad that you are joining us on our exciting journey as a listed company now, and into the future.

Moving onto the main part of my section, first, some operational highlights.

We have delivered 30,424 cars globally in the first nine months of this year, of which 9,239 in the third quarter, alongside continued expansion in existing and new markets. As of today, we are active in 27 markets on four continents, and have 128 Locations and over 1,000 Service Points.

We reaffirmed earlier this year, as well as today, that we are on track to deliver 50,000 vehicles by the end of 2022. We said we would catch up on production – and we did! Our strong partnership with Volvo Cars and Geely has allowed us to navigate through the supply chain constraints. The remaining 20,000 cars for 2022 have all been produced and are making their way, or being delivered to customers across the globe. Q4 2022 is expected to be our strongest quarter on record yet.

Moving onto financial highlights for the nine months ended September 30, 2022.

As this is our first earnings call as a listed company, I will focus on 9 months year-to-date commentary, versus the same period last year, and provide additional colour for notable exceptions for the third quarter.

Revenue increased 98%, from $748mn in 2021 to $1.48bn in 2022 - mainly driven by an increase in Polestar 2 vehicle sales across existing and new markets. This growth was partially offset by slightly lower revenue per vehicle due to product and market mix. And to put this into context – during the first nine months of 2021, we mainly sold long-range dual motor variants of the Polestar 2, while throughout this year we are also selling lower priced variants which have an impact on revenue per vehicle.

Gross profit increased from $1mn in 2021 to $57mn in 2022, leading to a gross margin increase from 0.1% to 3.9%. This was driven by higher Polestar 2 sales and lower fixed manufacturing costs. When we look at Q3 2022, gross margin was 0.9%, this a reflection of two factors. Firstly, a negative market mix from proportionally higher sales outside Europe, where revenue per car is typically lower. And secondly, from FX headwinds. As our cars are produced in China, the majority of our costs are in Renminbi which has strengthened against European currencies, leading to a higher cost of sales.

Selling, general, and administrative expense was only 31% higher at $625mn, compared to the 98% growth in revenues as we start to accrue benefits of scale. For the third quarter this year, SG&A expense was $20mn lower, compared to same period last year. This reduction was driven by management actions in curtailing advertising, marketing and promotional activities in anticipation of the expected lower volumes in Q3.

Research and Development expenses were down 22% to $123mn, due to lower amortisation of intangible assets, partially offset by higher spend on future vehicles and battery electric technologies.

Operating loss was 64% higher at $1.08bn, impacted by a $372mn non-recurring, non-cash, share-based listing charge in connection with the business combination that we reported in Q2 2022. Excluding this listing charge, operating loss increased 8%, from $658mn in 2021 to $709mn in 2022. For the third quarter of this year, operating loss decreased 33% to $196mn, benefiting from higher revenues and active cost management actions.

And lastly, net income for the third quarter was a positive $299m, due to the gain on the change of the fair value of the earn out liability and warrants of $561mn, which is primarily attributable to the change in the share price.

Moving on to balance sheet. At the end of September 2022, cash and cash equivalents stood at $988mn.

In regard to cash flow, cash used for operating activities year to date was $1.02bn, driven by an increase in working capital as well as higher operating losses and interest expenses. Cash used for investing activities was $653mn, mainly due to the cash settlements for the Polestar 2, 3 and 4 Intellectual Property investments. Cash provided by financing activities was $1.97bn. Driven by the net listing proceeds of $1.42bn and short-term working capital facilities totalling $1.56bn, partially offset by nearly $1bn in principal repayments.

As Thomas mentioned, we obtained a $1.6bn shareholder financing and liquidity package from our two major shareholders which demonstrates their commitment and confidence in our future.

This financial and liquidity package comprises of an $800mn, 18-month term loan from Volvo Cars, matched in terms of total amount by the direct and indirect financing and liquidity support from our other major shareholder, PSD Investment. You can find more detail on Slide 16 in our Investor Update presentation.

With the current macro-economic and capital markets environment as a backdrop the support from our major shareholders allows us to focus on ramping up the business to deliver the cars to our customers, for Polestar 3 start of production and first customer deliveries. This funding transaction also allows us time to unlock a broader range of longer-term financing alternatives when conditions in capital markets improve.

Before I hand over to the operator, let me wrap up with the outlook for the rest of this year. As I said before, despite continued supply chain constraints, we are on track to deliver on our full year guidance of 50,000 cars. We expect to deliver approximately $2.4bn in revenues, driven by strong Q4 2022 sales.

We expect gross margins in the fourth quarter to be broadly in line with Q3 2022 with similar pressures from product and market mix alongside foreign exchange. We do expect a greater impact from higher raw material costs to flow through, but to be partially mitigated by the vehicle price increases implemented earlier this year.

In terms of accessible liquidity, with $988mn cash balance at end September 2022, the $1.6bn shareholder financing and liquidity package, alongside other potential financing solutions, we anticipate adequate funding through 2023.

Thank you again for joining, and now over to operator for the Q&A section.

Questions and answers

(Operator Instructions) Now I'm going to take the first question, and it comes from line of Winnie Dong from Deutsche Bank. Your line is open. Please ask your question.

Winnie Dong – Deutsche Bank AG

Yes, I was wondering if you can quantify sort of how much mix in revenue and FX was impacting revenue and gross margin in the quarter? And then what are the puts and takes for the Q4 margin as well there.

Johan Malmqvist

In regards to FX, I think what I can say there is that if we look at the FX exposure we have, it's predominantly related to the fact that we have manufacturing in China and therefore, the exposure to the Renminbi. If just to provide some guidance on sensitivity, I think, which is the best way to answer your question. If we look at a full year impact of a 10% change in CNY versus SEK, that would equate to approximately $200mn on EBIT.

Winnie Dong

Okay, got it. And then sort of a similar headwind and regional mix expected for Q4 impacting Q4 margin thus putting it sort of in line with Q3 is that's the right way to think about it?

Johan Malmqvist

Yes, that's correct. That's our expectation that the Q4 margins would be broadly in line with Q3, similar pressures from the product and market mix alongside the foreign exchange.

Winnie Dong

Okay. Got it. And then I was wondering if you can also then provide a bit more color on the $800mn in capital from PSD. How much of that is committed? And any specifics on like what form or shape the liquidity might come through at?

Johan Malmqvist

Sure. So just to provide some more color then on this $1.6bn shareholder financing and liquidity package. On the one hand, there's the $800mn term loan from Volvo cars with an optional equity conversion feature in connection with the future equity raise by Polestar. This is then matched in terms of total dollar amounts by PSD, who will support via a combination of various financing arrangements and that's ranging them from funding certain assets, and that may include purchasing non-core assets or entering into sale and leaseback arrangements, also ensuring access to additional working capital facilities, and that may include them providing collateral support either directly or indirectly. And all of this, we expect to materialize during the course of next year.

Winnie Dong

That's very helpful. Thank you so much. And then how do we think about puts and takes for sort of 2023 in terms of demand? What are you seeing sort of in the U.S., Europe and China, how they're affecting demand into 2023 deliveries? Do you anticipate additional pricing actions?

Johan Malmqvist

So we were not planning on providing any 2023 outlook today. This is something that we will come back to and provide some guidance on our next earnings call when we cover the Q4 and the full year.

Operator

(Operator Instructions) And the next question comes from the line of Charles Coldicott from Redburn.

Charles Coldicott - Redburn (Europe) Limited

So my first one, on the comment about you having sufficient funds to last through 2023. I think the guidance that you gave during the De-spac process was that free cash flow would be close to neutral in 2024, but maybe that's changed. Could you tell us how much funding beyond this $1.6bn you need to eventually become self-funding and what year that will be?

Johan Malmqvist

Hi Charlie, so I think given all the current market uncertainty, we're not going to give guidance on a specific point in time. I think what we can say is that we do expect to breakeven within the context of us reaching our 290,000 volume plan.

Charles Coldicott

Okay, understood. And then just coming back to the gross margin in Q4 and maybe into next year. In the text of your document, you mentioned that price increases for batteries and other components that have already taken place in the market have not actually been experienced by you yet, because of the contract terms you have with Volvo. So could you talk about when you expect the impact of higher battery costs? And what will be the magnitude of that impact on the gross margin?

Johan Malmqvist

Sure. So when we look at raw materials, for example, we see that there was only a limited impact in Q3 from the increases in raw material costs. And then this is due to the time lag between when it's reflected in our building materials to when it flows through our P&L. With that being said, we also only experienced a limited impact from the previously implemented price increases this summer due to the price protection of the order book at the time. So we expect both of these to have a larger impact in Q4.

Charles Coldicott

And then Volvo launched the EX 90 yesterday. Now on a like-for-like basis, I think if I expect the cars with the same content, the launch version of the Polestar 3 long-range dual motor is about EUR 22,000 cheaper, which is about 20 percent than the EX90. Obviously, partial 5-seat versus a 7-seat to put a lot of the hardware and the battery pack capacity are identical. So how confident are you that the unit economics of the Polestar 3 are going to work on a much lower price point than the EX90?

Thomas Ingenlath

Well, I cannot confirm the EUR 20,000 that you refer here. I think that I cannot confirm there. And the picture is, of course, broader than that you have to look into U.S., China and Europe pricing. And then our pricing, of course is compared here with the Volvo pricing that includes LiDAR, where we have the pricing that you referred to with the pilot back without the LIDAR. So that will be, of course, an additional price on what you compare now. So all in all, we see that the positioning of the Polestar 3 price-wise is not at all. If you spec it rightfully at the same level is not at all below the EX 90 pricing. So that I cannot confirm. We are definitely going here for a premium price with the Polestar 3.

Charles Coldicott

Okay. Understood. If I can sneak one last one then. The U.S. market, can you talk about the impact of the inflation Reduction Act, which obviously means that you don't get the incentive on the Polestar 2 anymore whether or not you can rectify that? Or whether you can shift it to Charleston and how it will impact on Polestar 3?

Thomas Ingenlath

Yes, it's a bit difficult to comment on that because there are still too many uncertainties, and we have to see really the full picture in the next year. Our customers are already at the moment, excluded from that because of combined household income that takes them obviously above that threshold. So for that reason, this is set for now, not a major event for us. But again, it's a little bit too early to really comment on that, we have to see how it develops in the new year.

Operator

(Operator Instructions) And the next question comes from the line of Itay Michaeli from Citi.

Itay Michaeli - Citigroup Inc.

Just a couple of follow-ups. First, maybe I'm going back to the Polestar 3. I was hoping you can maybe put a little bit around what you might be seeing on reservations, broader demand as well as maybe what you're seeing by region and as well as a configurator, what portion of consumers might be choosing the performance pack for the Polestar 3.

Thomas Ingenlath

Yes, reception for Polestar has been fantastic. I mean the launch was we are satisfied and happy with the reception of it. You have to excuse me being a bit turning this around. We have much more focus now for us to really concentrate now on start of production of this car, first customer deliveries, that is what we are concentrating on our focus because we actually don't worry or are not in doubt about the customer demand here. We really want to make sure now that customers don't have to wait too long for the car and that we are actually able to deliver on that demand. And for that reason, that's our strong focus.

Itay Michaeli

Great. Thank you. And Thomas, how about the Polestar 4, maybe could you provide an update there on -- it looks like from the slides, it's still slated to launch next year. Just curious when you think production may start or if you can give us a little bit more color on when you may reveal that vehicle.

Thomas Ingenlath

Yes, that will be indeed part of our 2023 program to launch the car at least and where it will go into market first. We have the situation that, of course, the development of Polestar 4 is on track very well advanced. A little bit of explanation here, obviously, being spread out with the R&D forces here, having here the Polestar completely different team working on it secures that there is a very strong focus from that site on this development, and it is therefore nicely on track, and we indeed will be preparing to bring this car to market within 2023.

Itay Michaeli

Perfect. And then maybe just a last question maybe for Johan. As you think about cash flow in the fourth quarter. Any color you could provide on just how to think about working capital and maybe CapEx as well?

Johan Malmqvist

Yes, sure. working capital in the fourth quarter, I would expect an increase in working capital in the fourth quarter, but not to the same extent that we've seen year-to-date. And the fourth quarter working capital increase would then be driven primarily by an increase in accounts receivable following the higher sales in Q4, whereas I would expect inventory and accounts payable balances remain very similar to what they were in Q3.

In regards to CapEx, there, I would expect CapEx to be proportionately higher in Q4, but I would not expect it to exceed $1 million in total for the full year. I think any delta to prior CapEx guidance is related to timing rather to than a change in the investment spend. So that would rather spill over into the next year then.

Operator

(Operator Instructions) And the next question comes from the line of Alex Potter from Piper Sandler.

Alexander Potter - Piper Sandler & Co.

Great. So my first question is regarding, I guess, supply chain health, generally speaking. And then specifically also regarding outbound vehicle shipments from China. I know that generalized ocean shipping rates they seem to have been coming down by a lot recently. But specific to the auto industry, I've heard that there's still a lack of ships that can be difficult to find ships that are capable of exporting cars out of China. So given how important China is to your manufacturing footprint. Just interested in hearing anything that you're willing to share on that topic of ocean shipping rates. And then also, like I mentioned, more generally on just the status of the supply chain overall.

Thomas Ingenlath

Yes, when it comes to the logistics, yes, they are, of course, challenging that is something that everybody is experiencing. Having said that, we have very, very experienced partners supporting us in that. Us now having, for example, the 20,000 cars that have been produced that we still have to deliver to the 50,000 target, which we are confident in doing. Why are we confident? Because indeed, the logistics could be arranged. And yes, going out from China is one of the problems that you have to tackle in that, but there are alternatives around which we know how to deal with and work with and what we are using.

So generally, the supply chain issues, the Covid19 stuff, there is a big experience, but now over the 2 years that helps us to deal with that, specifically logistics is something that in the broader Volvo and Geely frame, this is something which is a very, very established and experienced organization that has been using these channels for the case and indeed have ways and means of how to cope with this.

Alexander Potter

Okay. Great. That's helpful. And anything regarding semiconductors that you would want to call out.

Thomas Ingenlath

Well, what to say about this. Semiconductors, yes, that's part of what I try to describe here 2 years of what I call the new normal have made us, of course, deal with this on a weekly, on a monthly basis. And this is something that will it change in 2023?

No, all the experience that we have collected now to deal with that, we will have to use again in 2023. Having said that, this catch-up that we have performed now here in August, September, October, of course, we're exactly under those conditions, and we managed after the Shanghai lockdown to ramp up our production, have higher production than ever for Polestar 2 under exactly those circumstances. And that is exactly where we feel, of course, as well that we go well prepared in 2023.

Alexander Potter

Okay. Great. Yes, I can appreciate it's a challenging environment for you and for everyone else. So I feel for you on that front. Maybe I'll ask questions. Just regarding sales and marketing. You mentioned that it ticked down here sequentially. Do you think that -- I guess, I'm interested in learning maybe why that's the case? Are you just trying to preserve capital? Do you think this is a good sales and marketing run rate? Or do you think it will pick back up again now that you're going to be pushing harder on Polestar 3. Just any commentary you could give on the outlook for sales and marketing spend would be helpful.

Johan Malmqvist

Sure. Our action to curtail that here in Q3 was in part driven by just recognizing that we would have the expected lower volumes. Of course, as we enter into Q4 and next year, we will ramp that back up again in order to support those volumes. So I would view it more as something that impacted Q3. With that being said, in light of the current market backdrop and of course, the macro environment that we have and is likely to persist, we are very stringent in our spend, specifically as it relates to our operational costs, not only advertising and promotion. And there, we are working across the company to identify and execute on cost efficient opportunities. And of course, that has to be balanced with the growth phase we're in. So we are very calculated in the areas we're looking to hold back spend on.

Operator

(Operator Instructions) And the next question comes from the line of Erik Golrang from SEB.

Erik Golrang - Skandinaviska Enskilda Banken AB (publ)

I have 4 questions, 3 of them have been asked. So I'll take the last one, and it sort of some help on your flexibility and manoeuvrability to the extent we get a clearly weaker sort of demand than economy next year. I mean you're saying now you're funded through 2023, and I assume that's based on your existing forecast, right? But let's say, things doesn't turn out as well as you expect, how much room is there for you to sort of cut down on CapEx, managed working capital a bit more efficiently on the OpEx side, marketing, etc. I mean how much room for weaker demand this there and while you still be able to keep/ stay funded through next year?

Johan Malmqvist

Yes. I think we recognize that the macro environment is challenging and likely persists. So we're not necessarily waiting for times to get worse. We're already now taking actions to make sure that we're very prudent in our spend. So managing our operational cost, it's absolutely a key priority and that we are already taking actions towards, like I said, identifying and executing on cost efficiency opportunities. And so that's definitely one avenue.

Another avenue that we already today are working actively with and it's just around the whole revenue management and of course, in regards to optimizing mix levels of sales support, etc. So I think if anything, all those work streams will just intensify, but again, we're not waiting for times to get worse. We're already acting on those now.

Thomas Ingenlath

And I think about this $1.6bn secure, of course, is as well the investment into our product portfolio. So that is in that way, secured and guaranteed that we will not have to compromise on that. Weaker market demand whatever. Of course, like we can work on marketing costs, not having to produce these cars automatically will be, of course, a different business plan for us. So I think the main key is with this funding support, we definitely can secure that we are on track, developing the company, our product portfolio, our business. So that's the projections, the ideas of where we want to be in 2025 are not influenced.

Johan Malmqvist

And I can just echo what Thomas said and the whole point of this is to safeguard the car programs. And so with the new three product launches we have over the next 3 years, we're really focused on delivering on those milestones and those for those products to then start generating the revenues and the margins.

Erik Golrang

Very good. And then if I could just follow up with -- to confirm what you said previously on the question of the Polestar 4. What did you say that we will see both the reveal and the production start next year? Or did you just confirm that it will be presented to us next year?

Thomas Ingenlath

Well, we will launch the car, and that is not -- I'm not talking here that we just go and present you the design of the car. That will be the start of the launch that includes, of course, as well industrial milestones that we will hit along the line in 2023.

Operator

(Operator Instructions) And the next question comes from the line of Charles Coldicott from Redburn.

Charles Coldicott - Redburn (Europe) Limited

Sorry, I thought I'd just jump back in if there was time. I want to ask on China as well. So I think, if I'm correct, you've only sold about 1,000 Polestar 2 in China this year? And I guess to an extent, you're prioritizing Europe because it sounds like it's higher margin for you. But is it demand in China is maybe a bit more muted than you would have liked? And if so, how do you solve that? Is it just that the domestic OEMs are very competitive when it comes to EVs in China...

Thomas Ingenlath

Well, obviously, the launch of the Polestar 3, and that I definitely should underline here, of course, the Polestar 4 will be very crucial products for us to get into a competitive and strong position here in China. And for that reason, we definitely expect and work on a market in China, where with Polestar 3 and 4, we will accelerate and make that as well an important part of our business.

Charles Coldicott

Okay. Understood. And then just another one on the latest funding round is from Volvo and Geely again. I wonder at what stage do you think the Volvo and Geely might be willing to perhaps relinquish some of their stake in order to increase the free float of Polestar?

Johan Malmqvist

Yes, Charlie, I mean, that's really a question for them rather than for us. The lockup from the SPAC transaction expires here in December. And of course, that will release the shares not only from our 2 major shareholders, but from other -- or from non-related parties as well, which over time should help the free float. But in regards to your specific question for the share, I think that's more of a question for our shareholders.

Operator

(Operator Instructions) There are no further questions at this time. I would now like to hand the conference over to our speaker, Thomas Ingenlath for closing remarks.

Thomas Ingenlath

Okay. Then thank you all for joining on our first quarterly results call. Let me then finish with 3 points just to summarize where we see the highlights of today. And that is definitely that despite the challenges that are affecting our whole industry, we are very delighted that we are on track to reach the target of 50,000 deliveries this year. Secondly, we have launched the Polestar 3. That's a major real milestone for our company, taking us into that premium SUV sector. And last but not least, the financing package secured from our shareholders allows Polestar to focus on delivering more cars to more customers. And as we talked about next year, you will not only see the first deliveries of the Polestar 3, but we will also launch the Polestar 4. I look forward to telling you more when we speak next time. And hopefully, see you as well each other along this exciting journey of Polestar in 2023. Thank you so much.