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VALMT.HE - Q2 2014 Valmet Corp Earnings Call

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## CORPORATE PARTICIPANTS

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**Pasi Laine** *Valmet Corporation - President, CEO*

**Markku Honkasalo** *Valmet Corporation - CFO*

## PRESENTATION

**Hanna-Maria Heikkinen** - *Valmet Corporation - VP - IR*

Good afternoon, ladies and gentlemen. You are warmly welcome to this news conference. My name is Hanna-Maria Heikkinen and I'm in-charge of Investor Relations.

We have two main topics on the agenda today. First of all, our interim report for January-June 2014 and then also our board of directors have reconfirmed the unchanged strategy and financial targets.

We will start with the interim report. Our CEO Pasi Laine will go that through together with our CFO Markku Honkasalo and then Pasi will also say a couple of words about our strategy and financial targets.

After these presentations, there is possibility to ask questions. Please, Pasi.

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**Pasi Laine** - *Valmet Corporation - President, CEO*

Okay. Thank you, Hanna-Maria.

Nice to be here again presenting Valmet's second quarterly results and first half-year results. As a topic, we have set or headline for the presentation, we have set a strong development in orders received continued and profitability improvement proceeding according to the plan. So we have had very good order intake again second quarter in a row and profitability has been improving as well.

So today, I will cover first the figures then something about the business line development. Markku will go through the financials in more details and then we have the guidance and short-term outlook, summary of the interim review and then we have also the strategy presentation as addition.

So if we go first the quarterly numbers and before the numbers, the content itself. So we are saying that our development in services has been stable. So our services business is about EUR1 billion, a little bit more than EUR1 billion orders received on par with the second quarter last year and improved from the second -- first quarter.

Our net sales was also stable compared to the last -- second quarter last year. So like we have been saying, we have stable profitable services business and that story continues and execution continues.

We have had a lot of success in orders received in our capital businesses. So second quarter in a row, our orders received in paper, pulp and energy are very good and like you will see later on, our order intake all together was over 1 billion in a quarter.

Net sales in capital business remained on the par level with last year and in paper, it declined reasonably much compared to last year. So as a result of the order intake and net sales, our order backlog continued to increase.

So the order backlog is now about EUR2.4 billion and if you compare that with the beginning of the year, it's 1 billion about last year and it's, of course, a lot of work for our organization compared to that beginning of the year.



Our profitability has been the focus of the management and the organization and it will continue to be the focus. So our EBITA improved compared to first quarter. It was about the same level in EBITA margins compared to last year's second quarter. But, of course, we have to admit that the profitability is still below the targeted level so we continue to work on that.

The profitability program which we launched about a year ago EUR100 million targets by end of this year. It's proceeding according to plan. And then, of course, we have also continued other methods like saving in our quality cost and procurement cost and those methods continue also in the later part of the year.

So even if our profitability has improved then, of course, the management is still very much focused in improving the profitability further. And then what's very good part of Valmet is that we have very good and strong balance sheets.

So our net debt was minus EUR54 million and the gearing is minus seven. So we have very good balance sheet. Cash flow provided by the operations was 46 million in the second quarter.

So all in all, I think Valmet's second quarter continued to build up very good and solid platform for Valmet to go forward.

The key figures, orders received about 1 billion and the whole six months altogether about EUR2.1 billion and I think that's very good achievement in this market situation. Our backlog is EUR2.4 billion like I said EUR1 billion better than beginning of the year.

Net sales for the quarter was EUR588 million and even if that's a little bit on low side, we were able to make EUR22 million operating profit EBITA which corresponds in EBITA margin to 3.7%. We are reasonably happy of the profitability improvement for the year and the profitability was developing like we have been planned.

EBITA was 2.8% positive and that's, of course, positive news as well. So I think these figures also demonstrate that the improvement of our operations from quarter one have been reasonably good and that demonstrates that we are on the good part in developing the company further.

Then the trends which I have been showing to you early as well, so the orders development trend has been good. Last year, the total order intake was about 2.1 billion and now we are about at the same level in two quarters.

So we have now in a row two quarters when the order intake has been over EUR1 billion. That's, of course, exceptionally in Valmet's history and I think it's creating good places for us to go forward.

If you look it from the business line perspective, services have been stable. Pulp and energy has been developing very well and also paper has been developing well.

And from areas, last time, we were talking about Asia Pacific and Asia Pacific being good and it has continued to be good. But the big strong area where we have a lot of good and active customers is Europe, Middle East and Africa.

So about EUR1 billion of our orders came from Europe, Middle East and Africa in the beginning of the year. That, of course, demonstrates that we have strong organization in Europe. We have good customer conduct and we have also customers who have been willing to invest in their businesses. So we are very pleased actually with the order intake development in Europe, Middle East and Africa.

Like I said, backlog has been increasing compared to the first quarter. It increased by [EUR434 million] (corrected by company after the call) and here you see nice on the graph that at the bottom, it was about EUR1.4 billion and now we had 2.4 billion. So then, of course, this creates a lot of work for us and stability in the organization as well.

I think the big thing is that that shows how well our customers have taken Valmet. So they trust Valmet and they want to develop their works and their processes further with Valmet.

From the backlog, about 80% is in capital business and about 20% is in services business. And we estimate that about 40% to 50% of the backlog will be realized as sales during 2014.

Then net sales and profitability development, like you see here, our net sales grew from about EUR520 million to close to EUR590 million in a quarter. Our EBITA improved from 0.7% to -- EBITA margin developed from -- improved from 0.7% to 3.7%.

We are still below the 6% to 9% target but it's obvious to see that we are narrowing the gap every quarter. First quarter, our EBITA was EUR4 million and now it was EUR22 million. So we are happy of that improvement as well. But like I said, the profitability improvement continues to be the focus of management also in the future until we are in the promised range between 6% to 9%.

Yes, you see others perspectives of the profitability improvements. So here's the gross profit on the left side and SG&A on the right side graphs and you see that gross profit has been improving in euros and it has been improving in percentage as well from the bottom which was in the end of the last year.

And then what this making big difference is that like you see there on the right side graph that our SG&A or sales, general and administration costs have been dropping a lot. And now they in the quarter a little bit less than EUR100 million.

And we say now that from the cost saving program of EUR100 million, we have now -- we see now full impact of the SG&A savings in our profit and loss statement. And, of course, the savings have been helping us to improve our profitability compared to last year.

And we are committed to continue the improvement of the profitability to be between 6% to 9% and here we have several things where we work -- which items we work. First of all, of course, we have to work with the improving project and service margins and there are several tools.

So one is, of course, to be more selective with the projects once we have bigger backlog. One is that we have to be very skillful in our project management to make sure that profit is improving during the project execution phase.

We still have room to improve our processes and we still have room to improve our localization of competencies. So we still have a lot of room to improve on that respect.

Quality costs are still an issue in Valmet. So we have a quality program established then and our target is to reduce the quality costs and by that way also improve our EBITA.

Procurement, the same, we have Valmet wide procurement program and there we increase sourcing from cost competitive countries, increase the subcontracting and make a lot of other actions to make sure that our procurement is as effective cost wise and quality wise as possible.

Then like I said that that EUR100 million program has been proceeding as planned and now we see the full impact of SG&A already from that plan. But that doesn't mean that we can stop with the cost competitiveness actions.

So, of course, also in the future, we have to make sure that if we have challenging operations, we continue to make sure that we improve our cost competitiveness in all the areas. And then, of course, we are now on a type of a business that product development place a lot of very important role in profitability.

So our R&D has been focusing now in many of our businesses, a lot to make more modular designs and standardized designs to make sure that our solutions are as cost effective as possible. And by emphasizing cost effectiveness in design in our R&D work, we assure that we can further improve our profitability in coming years and coming quarters.

So all in all, Valmet has many actions now ongoing to continue to develop the margin to the targeted level between 6% to 9%.

Then if we shortly cover the business lines, first, services business line like I said it has been stable. Orders received is stable, a little bit below the last year. So we are not pleased with the development.

So the target is to grow services and currently we are a little behind in order intake compared to last year. And we work hard on many front lines to make sure that the services start to grow again and then that's very much the focus area of the services business line and area management.

Net sales wise, we see that development is stable compared to last year and compared to earlier years as well. And so one can say that we have stable good 1 billion services business but it's not growing and we have to find the ways how to make it grow.

Then pulp and energy like you see on the order intake graph, we have very good success in order intake. So order intake all together is now about EUR1.2 billion and that's, of course, very good order intake in two quarters.

We have been successful in pulp mills. We have got three big pulp mills. We have been successful in energy power plants and we have been, of course, successful in rebuilds as well.

I think it's very good change in our backlog, in our market position and that demonstrates like I said that the customers have very much respect to our technologies and solutions currently.

Net sales have been declining due to last year's order intake and the last quarter was about EUR230 million. But, of course, you will see in coming months that the big backlogs start to help us in net sales as well.

In paper, if we start from the net sales, so that describes very nicely how through -- how big changes we are going in paper side -- paper business. So last year, the net sales was about EUR218 million and this year, the quarter was 108 million so about half of the volume.

And we have been adjusting our capacity of our organization to the new market situation and we have been doing a lot of actions there. And now the market is improving like you see on the left side graph that first quarter was EUR212 million and the second quarter was EUR190 million.

So we have two good quarters now in paper business order intake as well. And that, of course, gives us confidence that the future in paper business will be good as well. We are very pleased with the order intake development in paper and board and tissue currently.

Here, you see the long list of our customer activity. So we have announced a lot of orders in the first quarter and the second quarter and that -- what is good is that it's coming from pulp and energy, it's coming from pulp mills, power plants, paper mills, tissue mills, and recovery boilers. So almost all the capital businesses what we have seen nice increase in order intake.

So that was shortly the business update and then Markku will go through more in detail with the financials.

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**Markku Honkasalo - Valmet Corporation - CFO**

Okay. Thank you, Pasi, and good afternoon also on my behalf. As a reminder, please remember that the numbers in 2014, they are actual numbers and all the comparison numbers are carve-out numbers.

In second quarter, the good cash flow generation continued. Cash flow before investment was EUR46 million and biggest impact came from the change in net working capital which was EUR23 million.

Cumulatively, cash flow before investment during the first half of the year was EUR89 million. Our gross -- net investment was EUR70 million and cash flow after investment was positive EUR71 million.

Out net working capital was minus EUR249 million which is roughly minus 10% of our rolling 12 months net sales. And our depreciation during the first six months was EUR25 million. So our CapEx -- gross CapEx, it was EUR21 million, was less than the depreciation.

At the end of the June, we had EUR54 million more cash and on cash equivalent than we had interest bearing debt. So our net gearing was minus 7%. Our total equity was EUR782 million which turns in to 40% of equity ratio. Capital employed at the end of June was EUR967 million.

Our structure of loan and borrowings, so interest bearing debt at the end of June was EUR185 million consisting EUR89 million EIB loan and then EUR72 million term loan. And then the combination all in all EUR24 million different financing sources.

The average maturity of our long-term loan portfolio is 2.7 years and then the average interest rate was 2.8%. In addition to the drawn facilities, we have two back-up facilities EUR200 million domestic commercial paper program out of which EUR5 million was drawn at the end of June. And then EUR200 million syndicated revolving credit facility which was totally drawn and that the maturity of that loan is December 2018.

So that was briefly the finance source and then I will give it back to Pasi, please.

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**Pasi Laine** - Valmet Corporation - President, CEO

So guidance and short-term market outlook. So first to guidance, so we keep the existing guidance like it has been that Valmet estimates that net sales in 2014 will decline from the 2013 level and EBITA before non-recurring items will increase in comparison with 2013. So it's exactly the same like it has been and that's the guidance now from Valmet.

Then short-term market outlook, we have been saying that all the market outlooks have been satisfactory from our perspective. And now, after we have been successful in getting orders in board and paper and after we have been cutting capacity in paper and board and after we see that the market activity continues to be good, we have seen the reasons to upgrade our market outlook for paper and board to good level.

So it's combination of three things. We have been successful in order intake, we have been cutting capacity and we see that the market continues to be active and all these three components have resulted that we have upgraded our paper to level good.

And all the other markets, we keep to satisfactory level also for coming six to nine months. So that's the update on the market outlook. So some positive news on that.

So from the quarter one perspective as a summary that our services are stable. It has been developing in a very stable way. But like I said, of course, we are not satisfied because we are looking after growth in services.

We have been very successful in capital business order intake. All the order intake has been increasing a lot in paper and pulp and energy businesses. Our backlog has increased, it's EUR2.4 billion now and it's 1 billion up compared to the beginning of the year.

Profitability improvement is going according to plan. EBITA margin has been improving compared to last first quarter. EBITA was about the same level as last year and improved from quarter one. Profitability improvement program has been proceeding according to plan and we have further actions to improve the profitability.

And then like Markku explained, we have strong balance sheet. Net debt is minus 54 million and gearing is minus 7%. So Valmet is very solid to go forward in all the respects.

And then I still want to go through the strategy papers like Hanna-Maria said. So our strategy is called Valmet's Way Forward and we continue with the same strategy what we announced in the beginning -- end of last year.

We discussed it a lot and we thought that it's still very good way to describe what Valmet is doing. So our mission is to convert renewable resources into sustainable results.

And we see that there is more and more need all the time in the new economy and new world to use sustainable resources to make renewable products. We have the technology company who makes that possible.



Our strategy is to develop and supply competitive technologies and services to the pulp and paper and energy industries. And we are committed to moving our customers' performance forward.

So we serve pulp, paper and energy industries with technologies and with services and very important task for Valmet is to take the performance of these industries forward. And that's why we invest quite a lot of money in R&D and like we have been announcing also that we are getting all the new applications and developing new applications, new technologies by which our customers can use renewable raw materials to make sustainable products.

Then for strategy executions, we have defined must-wins for Valmet. These are categorized on the four segments. So customer excellence and there the goal is to build up as close to customers as capable teams as possible. And there, Valmet has still opportunities to improve.

In technology, we want to be leader in technology and innovation meaning that we innovate some new things but then at the same time, we have to have a focus to innovate also new more cost-competitive products which are required by our customers who not all are making a lot of profit.

In processes, we still have work to do to improve our quality, improve our procurement but to improve our project management and sales processes as many others and there's a lot of work still in Valmet to improve the internal efficiency.

And then what is important is the personnel and how we take them with and there, we have must-wins and we will launch our values, new values soon and that will make sure that that we start to share more and more the same values in developing Valmet as one team together forward.

And then once we have implemented must-wins, our vision is to become the global champion in serving our customers and like I've been saying earlier, the important word here is to champion in serving our customers. So we could become the global champion and arrogant but we want to remind ourselves that we want to become the global champion in serving our customers and not to become arrogant.

So that's the strategy which has been approved -- reapproved by the board and it was the first time when Valmet's board was approving it and that's why we've wanted to take that up also here.

And the financial targets are unchanged so we want to grow with the net sales so that we exceed that market growth. EBITA, the profitability target before non-recurring items is between 6% to 9%. Return on capital pretax should be minimum 15% and dividend policy is to pay out at least 40% of the net profit. So these targets are unchanged as well.

So, thank you for listening and if I understand correctly now --.

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## QUESTIONS AND ANSWERS

**Hanna-Maria Heikkinen** - *Valmet Corporation - VP - IR*

Now it is time for the questions. So if you could kindly, Pasi and Markku come here and we will start with the questions from Keilasatama. Do we have questions from here?

If there are no questions from Keilasatama, we will continue with the international questions. Are there questions from the line?

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### Operator

(Operator Instructions).

There are no questions from the telephone line. Please continue.



**Hanna-Maria Heikkinen** - Valmet Corporation - VP - IR

It seems like the presentation was very clear. So there are no further questions. Is there still something you'd like to add or highlight?

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**Pasi Laine** - Valmet Corporation - President, CEO

We were so much expecting to get a lot of questions. So the highlights are still that order intake has been good. Backlog is up. Profitability improvement programs are going on and Valmet is committed to make profit -- to reach the profit targets what it has. Valmet is going forward.

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**Hanna-Maria Heikkinen** - Valmet Corporation - VP - IR

Yes. So we are on the right track?

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**Pasi Laine** - Valmet Corporation - President, CEO

We are on the right track.

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**Markku Honkasalo** - Valmet Corporation - CFO

We are on the right track and also just to mention that return on capital employed during the first six months was 3% positive. It's not where it should be but it's going to the right direction as well together with the improved profitability.

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**Hanna-Maria Heikkinen** - Valmet Corporation - VP - IR

That's a relevant point.

So if there are no questions, I'd like to warmly thank you for this excellent and very clear presentation and the Q3 report, it will be published on October 24th.

Looking forward to meet you all then. Thank you.

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**Pasi Laine** - Valmet Corporation - President, CEO

Okay. Thank you.

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**Markku Honkasalo** - Valmet Corporation - CFO

Thank you.

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