THOMSON REUTERS

EDITED TRANSCRIPT

Q1 2020 Valmet Oyj Earnings Call

EVENT DATE/TIME: APRIL 23, 2020 / 10:30AM GMT

CORPORATE PARTICIPANTS

Kari Juhani Saarinen *Valmet Oyj - CFO*
Pasi Kalevi Laine *Valmet Oyj - President & CEO*
Pekka Rouhiainen *Valmet Oyj - Director of IR*

CONFERENCE CALL PARTICIPANTS

Antti Suttelin *Danske Bank Markets Equity Research - Head of Research of Finland*
Johan Eliason *Kepler Cheuvreux, Research Division - Analyst*
Manu M. Rimpelä *Nordea Markets, Research Division - Head of Equity Research of Finland & Senior Analyst*
Tomas Skogman *Carnegie Investment Bank AB, Research Division - Head of Research of Finland*
Tomi Markus Railo *DNB Markets, Research Division - Analyst*

PRESENTATION

Pekka Rouhiainen ***Valmet Oyj - Director of IR***

All right, ladies and gentlemen, welcome to Valmet's Q1 2020 Results Publication and Webcast. My name is Pekka Rouhiainen. I'm the Head of Investor Relations here at Valmet. And with me today are Pasi Laine, President and CEO; as well as Kari Saarinen, CFO.

After the presentations, you will have the chance to ask questions over the phone lines as we have no physical audience here at Keilasatama today. But without further ado, Pasi, please go ahead.

Pasi Kalevi Laine ***Valmet Oyj - President & CEO***

Thank you, Pekka. So welcome. So our headline is now that orders received increased to EUR 1.2 billion and comparable EBITA to EUR 52 million.

First, I will go through the quarter in brief, then a couple of words about the business line development. Kari will go through the financial development. And I'll talk about dividend proposal, guidance and short-term market outlook.

First, the quarter in brief. So our orders received in stable business increased to EUR 514 million. In capital business, orders received increased to EUR 697 million. Our net sales increased to EUR 821 million. Backlog increased to about EUR 3.6 billion. And comparable EBITA increased to EUR 52 million, and margin was 6.3%. Our gearing in the end of the quarter was -22%.

Now then quarter 1 in graphs. So orders received totally was EUR 1.187 billion. Net sales, like I said, EUR 821 million. Comparable EBITA, EUR 52 million. And comparable EBITA margin, 6.3%. We employed in the end of the quarter almost 13,600 people.

This time, if we look the geographical graph first. So you will you see that South America was big, and that was, of course, due to the big pulp mill order we got in South America. So South America was 22% of our order intake. China was 21%. So China has been active like we were also estimating in last year. So China was 21% of our order intake. Europe was 32%, continued to be strong as well.

Business line-wise, capital was very strong in this quarter, and that's why Pulp and Energy and Paper together accounted to almost 60% of the order intake. And stable business or Services and Automation were, of course, then a little bit less.

Here's the graph, how our order intake has been developing. So this quarter, order intake was EUR 1.187 billion. And 12 months cumulative curve is now at the highest ever, so 4 point -- almost EUR 4.3 billion and -- or EUR 4.3 billion. And that's, of course, nice trend to look at.

Then stable business. Orders received increased as well, and it totaled EUR 1.828 million during last 4 quarters. And this graph is, of course, also nice to look at and shows that we have been growing organically our stable business as well as, of course, with acquisitions.

Backlog ended up at almost EUR 3.6 billion in the end of the quarter, and it's the record backlog for Valmet during all these years Valmet has been operating. And it's about EUR 223 million higher than it was in end of last year. Now we are saying that about 60% of backlog is expected to be realized as net sales during 2020. And last year, the same percentage was about 65% and the corresponding number was EUR 3 billion then. And then you can calculate that we have a little bit more backlog now to be recognized this year than last year. We are saying also that about 30% of the backlog relates to stable businesses, the rest to capital businesses.

Then a couple of words about the business line development. First, Services, orders received and net sales increased. So orders increased in the -- orders received in Services ended up at EUR 398 million. Out of that, EUR 37 million came from the acquired businesses, which then means that the growth organically was 1%. Are we happy with 1%? In normal circumstances not. And then maybe now during these little bit more special times, we are happy that we were able to grow by 1%.

Net sales increased as well -- and ended up at EUR 295 million. And there, the acquisition impact was EUR 37 million, which means that actually our net sales in comparable operations declined compared to last year.

Orders received increase came from many areas and also business unit-wise, especially Energy and Environment was strong; Performance Parts as well. And then we had challenges in order intake, which means that it decreased in Mill Improvements and in Fabrics. COVID-19 had a negative impact to our net sales, especially in field services, mill improvement projects and energy services. So those kind of services where we have to visit customers it has been very difficult to execute the projects to the end or execute the field services, which customers would like to have us to deliver. And of course, we expect that that challenge will continue or even get worse in second quarter.

And then still something about the order intake in Services. So we saw stronger demand first 2 months and beginning of March. And then COVID impact started to show up in order intake numbers and also net sales numbers in latter part of March, mainly.

Of course, China impact was already in, in February.

In Automation, our orders received increased to EUR 116 million. And that's, of course, nice number. And then net sales increased to EUR 80 million. Here, COVID has the same kind of limitations. So we have quite a lot of experts who are visiting customers every day doing different kind of field services, expert services and mill improvement projects. And now when there are some limitations in traveling and also visiting customers, then of course, it's more and more challenging to execute that kind of services at the customers. Of course, our teams are looking to use as much modern tools, remote connections, remote work as possible, both in Automation and Services. But of course, these COVID limitations has an impact to our revenue recognition and has had -- will have it as well in the future.

Pulp and Energy. Orders received and net sales increased. So orders received were EUR 376 million. In the graph, you'll see that now the order intake is a little bit over EUR 1.3 billion in 12 months cumulative curve. South America was strong. Europe was strong and Asia Pacific, North America, China are not as strong as last year. Our orders received increased both in Pulp and Energy.

Then the interesting topic during last years have been marine scrubbers, and now the marine scrubber orders were only EUR 4 million in this quarter. COVID will have an impact in Pulp and Energy as well. So customers are closing some sites so that we can't execute anything or we have challenges to send our specialists to work on sites or our subcontracts to do some installation work, and that will, of course, have an impact to our net sales in this year. But otherwise, I will come back later on the outlook, the outlook for Pulp and Energy is actually still good.

In Paper, our orders received and net sales increased as well. Paper orders received ended up in EUR 321 million. That's, of course, nice number. Orders received increased in China and EMEA, decreased in the other areas. And orders received increased both on Paper and -- Board and Paper as well as in Tissue.

Net sales increased compared to last year and the same impact -- COVID has the same impact in Paper as in Pulp and Energy. And there, the difference between these two businesses is that, actually, majority of the work what we do in Paper is done in our offices, in our factories, in our subcontracting. So out of the value, what we have in backlog and in orders totally is less depending on site work than in Pulp and Energy. And that's why the impact of COVID and site closures will be a little bit less in Paper. But of course, it has an impact.

And then if I say a couple of words about the supply network, then of course, it's obvious that we will have challenges with our supply network, especially in countries like India, where the whole country has been locked down for several weeks. And we have quite big part of -- not big part, but we have projects where a big part of the subcontracting or our own manufacturing is happening in India.

So now it's Kari's turn to go through the financial development.

Kari Juhani Saarinen ***Valmet Oyj - CFO***

Thanks, Pasi, and also good day on my behalf. So looking at our quarter 1 performance. So orders received were all-time high, EUR 1.2 billion. That's exceeding a year ago by 42%. Both capital businesses increased. Pulp and Energy business line increased by 87% and Paper business line by 76%. Automation total orders, they increased by 13%, and Services increased by 11%. Services organic growth was 1%, as Pasi mentioned.

About the areas, so South America and China were strong. Also good growth in EMEA. North America and Asia Pacific actually reduced with the orders. Interesting point here is that China orders for the quarter 1 were the same as full last year.

Order backlog, that was at EUR 3.6 billion. This is a record-high quarter end for Valmet. 60% of the order backlog will be recognized during the year. That's around EUR 100 million more than last year at this point of time.

Net sales for the quarter, EUR 821 million. This is 20% higher than a year ago. Pulp and Energy increased a lot, 50%. And Paper business line, 16%. And Automation total by 10%. Services increase was 7%. But Services organic growth with net sales actually was negative, so it reduced by 7% or EUR 18 million. So Services net sales was impacted by this pandemic and as the access to customer sites was limited and also China was closed for almost a month.

Net sales to South America, Asia Pacific and EMEA, they increased. North America was flat and China reduced. Well, overall, during the quarter, capital businesses were strong. Capital had 59% share of the quarter's orders and 56% of share of quarter's net sales. Typical split is 50-50, if we look at a bit longer term.

Our EBITA for the quarter, EUR 52 million, 9% higher than a year ago. EBITA was 6.3%. That is 0.6 percentage points below last year's EBITA percent.

Cash flow for the quarter, EUR 173 million. Last year, we started with EUR 30 million cash flow. Gearing reduced to -22%.

Then looking at gross profit and SG&A development. So gross profit for the quarter, that was around EUR 30 million higher than a year ago. Gross profit percent was 1 percent point below, so then that comes from the capital businesses' share, which was then this 56%. Last year, it was 51% for the quarter. So this explains a bit lower gross profit percent.

And then looking at quarter's SG&A. So quarter's SG&A has actually increased. 60% of the increase is coming out of the acquisitions. So far until the end of quarter 1, we haven't had any major reductions for some of the, like, activity-related costs such as travel costs due to coronavirus.

And then looking at our comparable EBITA. So last 12 months EBITA was now at 8.7%, so no increase here. Our EBITA target remains between 10% and 12%. That we actually set end of last year.

Looking at cash flow. So cash flow was strong, as said, at EUR 173 million. So we have now had 3 strong quarters each over EUR 100 million cash flow. The good development at cash flow was actually driven by good development at net working capital, and this net working capital was -14% of rolling 12 months orders received. So it was in a kind of very low level. And Valmet has a principle that capital orders are only booked once Valmet has received down payments or letter of credit or similar security. And we had actually a strong quarter with capital order intake now. Also, the accounts receivables developed very favorably and also the overdues over 60 days reduced.

Net debt and gearing. Gearing was -22%, and net debt was EUR -220 million. Without lease liabilities, gearing would have been -28%. End of the quarter, we had EUR 466 million cash and EUR 186 million loans. And on top of that, Valmet has an unused EUR 200 million committed revolving credit facility, which matures year 2024.

And then return on capital employed and capital employed, so capital employed was EUR 1.3 billion end of the quarter. Out of this, equity was around EUR 1 billion. Rolling 12 months capital -- return on capital employed was 23%. And here, our target is more than 20%.

Okay. Back to you, Pasi.

Pasi Kalevi Laine ***Valmet Oyj - President & CEO***

So -- then it's dividend proposal, guidance and short-term market outlook. So the Board of Directors have decided to keep the same dividend proposal than earlier. Our policy is saying that we pay out at least 50% of net profit as a dividend. And the dividend proposal is now EUR 0.80 per share. And here, you see how it has been developing over the years. So it's starting from EUR 0.15, went to EUR 0.25. Last year, it was EUR 0.65. And now Board of Director is proposing for AGM to approve EUR 0.80 a share dividend for 2019.

Then our guidance and short-term market outlook. Like we announced April 16, Valmet announced in April 16, 2020, that the company, withdraws its guidance for 2020, due to the increased uncertainty related to the COVID-19 pandemic. And that's, of course, still the situation.

Then if we look the short-term market outlook, where we -- like we have been earlier saying -- take into account the current workload and then also the activity level in the market. And in services, we had good market outlook end of last quarter. And now we are dropping that to satisfactory and weak. And why we are using 2 different words here is -- has a reason. Like I have been saying, it's very difficult now to execute mill type of projects and field services. And that has -- will, of course, have an impact to the demand of those services as well. And that's why we are saying that the demand is weak. We also have had -- started negotiations in Finland to start temporary layoffs for persons who are working on that field services part -- in Services and EMEA. I don't know the exact amount -- person to whom it's affecting, but we are talking about Services and EMEA organization. And we have started also some temporary layoffs in our North American organization for the same reason.

And then at the same time, when you are looking at our customers coming out with their announcements, they are saying that production volumes are still reasonably -- or they are satisfied volumes. And that's why, of course, part of our services will continue to have a satisfactory demand. So that's the explanation between using two words, satisfactory and weak.

In automation, we are dropping from good to good and satisfactory and the same explanation. So we still have active sales pipeline in Automation, but COVID is impacting part of our services and also demand of those services. And that's why we are saying that the demand is either good or satisfactory.

In Pulp, we booked nice orders in quarter 1, but we still have active sales pipeline for capital cases, and that's why we keep our outlook for pulp as good.

In energy, our outlook has been satisfactory and we'll still keep the satisfactory also for energy.

In board and paper outlook was good, and we keep it at a good level. So we still have active negotiations ongoing with customers for pulp and paper machines. And tissue, we had satisfactory and we'll continue to keep the satisfactory level also for coming quarter.

So changes in services and automation and the rest are seen to be at the same level where they were in the end of last year.

Good. Now Pekka, it's your turn to say that we'll go to the other side of the room.

Pekka Rouhiainen ***Valmet Oyj - Director of IR***

Yes, exactly. Thank you, Pasi. So we will now take the questions. And according to my information, we already have some questions over the phone lines, and we will now go directly to the phone line questions. So operator, I now hand over to you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question today is from the line of Manu Rimpelä from Nordea.

Manu M. Rimpelä ***Nordea Markets, Research Division - Head of Equity Research of Finland & Senior Analyst***

My first question would be on the service operations. So I think you reported some 6% decline organically in the sales in Q1. And I was hoping that you would be able to help us to understand a bit better the profile between the different months in January and February, was sales still up. And what kind of run rate did you see in March? And maybe the first comments on April after this kind of lockdown impacts are becoming more visible. That would very much help us to understand what type of run rate we are, at the moment, in.

Pasi Kalevi Laine ***Valmet Oyj - President & CEO***

Okay. So like I said, order intake was developing better in the first two months and still beginning of March. And then last 2 weeks in March, we had, more generally, the drop in the order intake. In China, it was in the beginning of the year, and then it bounced back. So actually, China totally was okay-ish in orders received in first quarter. And now of course, the COVID is spreading around the world. So of course, we estimate that the order intake, especially for mill and -- no, especially for mill, maybe even roll, will continue to be weak for the second quarter.

And then it's very difficult to say that -- how the market will develop later on because our customers now have to postpone their annual shutdowns. And then, of course, there is a need for the annual shutdown. So I'm sure that when the restrictions, travel restrictions are lifted and when customers are more sure that they can continue the operations even if they have some COVID cases in the operation, then there will be, again, not a boom, but activity on this mill services -- which they can't now perform. -- Because those are, of course, partly even legally required works, what they will be performing. So all in all, it's -- we estimate that now the activity in second quarter will be weak to satisfactory. And then it will be bouncing back. But then, at what time it will bounce back, we are not sure yet.

Manu M. Rimpelä ***Nordea Markets, Research Division - Head of Equity Research of Finland & Senior Analyst***

Okay. Then in terms of the equipment and these large projects, slightly surprised that you see very kind of -- or an active and a positive pipeline of new orders, given that we are seeing a lot of your customers starting to cut CapEx. So could you just help us to understand a bit better where exactly do you see customers being active? And also, what do you see is the risk that these kind of orders will be pulled in the coming months as the customers also realize the situation?

Pasi Kalevi Laine ***Valmet Oyj - President & CEO***

So the ones where we are now actively negotiating are such that customers have been planning the project for a long time. And of course, the investments are for long-term demand forecasts. And I think all of us are still seeing that the mega trends, which are valid in our industry, will continue to be valid also after corona. So it's difficult to see the future without the pulp demand growing. It's difficult to see the future without tissue demand growing or renewable packaging demand growing. And part of our customers are now saying that even if there is short-term turbulence in the market, they want to continue to invest to the industry where they see that in long term the market drivers are right.

Kari Juhani Saarinen ***Valmet Oyj - CFO***

And also, one thing to remember here that, that many of our customers are very good-quality customers with strong balance sheets and like long-term outlook. And maybe some of them also are thinking that , specifically on the manual labor side, they can actually now have very good purchasing power.

Manu M. Rimpelä ***Nordea Markets, Research Division - Head of Equity Research of Finland & Senior Analyst***

Okay. And final question on the cash. How should we think about the cash flow for the kind of remainder of the year, given that it was exceptionally strong now probably due to timing of some projects?

Kari Juhani Saarinen ***Valmet Oyj - CFO***

Well, that's exactly what you said, that we have a bit too much cash now. So because once we book orders, we have strong capital orders, we have down payments from the customers, and now we had a bit of an exceptional good situation now end of March. And I think that we would be very surprised that the net working capital level stays with that -14% on rolling 12 months orders.

Pasi Kalevi Laine ***Valmet Oyj - President & CEO***

And that's not a historical average.

Kari Juhani Saarinen ***Valmet Oyj - CFO***

Yes, it's not -- average is a couple of percentage points less.

Operator

The next question is from the line of Antti Suttelin from Danske Bank.

Antti Suttelin ***Danske Bank Markets Equity Research - Head of Research of Finland***

Just one quick that I understand. Your Services orders organically increased by 1%, but sales fell organically by 7%. And so why don't they go more in hand in hand? How can your orders increase, but then the sales fall so much? What's the reason for the gap?

Kari Juhani Saarinen ***Valmet Oyj - CFO***

Well, thanks, Antti. So like in normal circumstances, so this is what happens, so that the first half of the year, we have much higher Services orders than in the second half of the year. And then with the net sales, it goes the other way around. So that's the normal pattern or seasonality during the year. And then also now specifically, what Pasi was explaining that certain part of the sales that requires customer acceptances and also -- and requires our presence at customer site, so this kind of work we couldn't perform even though we had the orders in hand.

Antti Suttelin ***Danske Bank Markets Equity Research - Head of Research of Finland***

Yes. So they ordered even if they didn't actually want the service yet?

Pasi Kalevi Laine ***Valmet Oyj - President & CEO***

No, they might have -- like if you talk about shutdowns, then the order might come 6 months earlier, before the shutdown itself happens, and then it's in our backlog. And then once we execute the shutdown service, then it's recognized as revenue. And now we haven't been able to execute the jobs.

Operator

The next question is from the line of Johan Eliason from Kepler.

Johan Eliason ***Kepler Cheuvreux, Research Division - Analyst***

It's Johan here. Just a question, you obviously still propose a dividend for the year. You obviously generated good cash now and last year. But aren't you worried that those orders in the pipeline might not come through and your project business will basically consume all of your cash that you have on the balance sheet now in the remainder of the year and potentially, I mean, the hit on the Service businesses could be harder and longer than anticipated at the time being? How have you thought about the sort of the balance sheet from the risk perspective?

Kari Juhani Saarinen ***Valmet Oyj - CFO***

Well, of course, Johan, if we look at the balance sheet, so we have EUR 280 million more cash than debt, if we exclude the lease liabilities. And of course, we are cautious. And -- but our fourth financial target is that we pay more than 50% of net profit as dividends, and now this is what we are proposing, EUR 0.80 per share, that's 59% of net profits. And we haven't seen any calculation of the projects. That's, of course, possible. But we need to remember that there's quite like substantial amount of the down payments that customer have -- customers have remitted to Valmet. And that typically means that it's painful for the customer to withdraw.

Johan Eliason ***Kepler Cheuvreux, Research Division - Analyst***

Yes. But obviously, delays could happen, I suppose. But I mean, isn't it so that those milestone payments during the project as well, or?

Kari Juhani Saarinen ***Valmet Oyj - CFO***

Of course, there are milestone payments during the projects, and there could be some delays. But what we were talking here that with the Paper business line projects, so typically, we do that 95% ready before we ship it to the customer. So we recognize revenue also 95%, and that means that the milestone payments are even then a bit more than that. And then with the Pulp orders, yes, there's more site work, but that's typically done with the local resources. And these resources typically are available, unless the sites are closed. And we have had a couple of these cases, but that is not the majority at all.

Operator

The next question is from the line of Tom Skogman from Carnegie.

Tomas Skogman ***Carnegie Investment Bank AB, Research Division - Head of Research of Finland***

Yes. It's Tom here from Carnegie. I was wondering about also this: how would you handle possible kind of request for cancellations or large postponement that will impact your delivery schedules and manpower. I mean you are dependent to do business with these customers in the future as well.

Pasi Kalevi Laine ***Valmet Oyj - President & CEO***

So of course, in our business, we all the time have delays in some projects. So part of the projects go exactly like planned in the beginning. And in part, there are different kind of delays. Customer has delays, for example, with the construction work. So we all the time are used to change to time schedules in our projects, and that will continue to be so.

Then in possible cancellations, there, our business principle is that we have more cash all the time or advance payments are bigger than our costs. So we are not financing customers' projects. So in case that somebody would cancel a project, then we would stop the work and then start negotiations at what happens with the -- with the goods we have produced already. And like Kari said, they have paid already quite big amounts, so it will be very expensive exercise for customers to stop the project. It has happened in 2008 for 1 big project, but that's not very common that, that kind of thing happens.

Tomas Skogman ***Carnegie Investment Bank AB, Research Division - Head of Research of Finland***

And then I wonder about the summer break. I mean you have postponements in Services. Is there a chance that you get a pick up in -- during the summer holidays? Have you heard that the pulp and paper companies would plan some extra holidays or so that could open up a possibility for you?

Pasi Kalevi Laine ***Valmet Oyj - President & CEO***

Sorry. If summer vacations would open?

Kari Juhani Saarinen ***Valmet Oyj - CFO***

Summer breaks.

Pasi Kalevi Laine ***Valmet Oyj - President & CEO***

Summer breaks. I think in, in the cases where we have a restriction to work, the customers have implemented rules that nobody outsider can enter their manufacturing facilities. And that's not depending whether they produce or whether they are not producing. And before that kind of customers will lift their limitations, then it's difficult for us to execute certain mill projects. But of course, then from the other side, part of the customers are all the time learning also how to live with this COVID situation and learning new ways; like in automation, they have even built in other control rooms where our people can work so that they are not in contact with customers' personnel. So people are innovative when there is need to be innovative.

Tomas Skogman ***Carnegie Investment Bank AB, Research Division - Head of Research of Finland***

And then finally, about your acquisition pipeline. With the risk of demand slowing down, I mean, it will be a perfect time to do some acquisitions this year with your strong balance sheet. Do you have higher or lower hopes than normally in the current situation?

Pasi Kalevi Laine ***Valmet Oyj - President & CEO***

We'll continue to work on acquisition topics as well for the -- exactly for the reasons you mentioned that might be that it would be a good time. And then, of course, we have balance sheet now as well, a strong balance sheet. But then, of course, might be that not so many are eager to sell at this point of time.

Tomas Skogman ***Carnegie Investment Bank AB, Research Division - Head of Research of Finland***

I guess it depends on how much you're prepared to pay. It could even make sense to pay up a bit more to get the right companies.

Pasi Kalevi Laine ***Valmet Oyj - President & CEO***

We have to report the price... Tom, we have to report the price to you, so we have to be careful to satisfy you.

Kari Juhani Saarinen ***Valmet Oyj - CFO***

It's -- but it's always the case of how much we are prepared to pay. So that's always like that.

Tomas Skogman ***Carnegie Investment Bank AB, Research Division - Head of Research of Finland***

Yes. You basically have a good pipeline, and then people are prepared to sell companies to you. That's your view. All right.

Operator

The next question is from the line of Tomi Railo from DNB.

Tomi Markus Railo ***DNB Markets, Research Division - Analyst***

It's Tomi here. Can you give any comment on the financial performance of the acquisitions you made last year? We heard the contribution on the sales and orders. But how have those companies developed from profitability point of view?

Pasi Kalevi Laine ***Valmet Oyj - President & CEO***

They have been performing according to our expectations.

Tomi Markus Railo ***DNB Markets, Research Division - Analyst***

And sustaining the levels you mentioned in connection to the acquisitions?

Pasi Kalevi Laine ***Valmet Oyj - President & CEO***

Yes. And now they are more integrated into our operations. So it's -- once you integrate it, thereafter, it's more and more difficult to follow them as independent units. But they are performing like we have been expecting.

Operator

(Operator Instructions) There are no other questions coming through, so I hand back to the speakers.

Pekka Rouhiainen ***Valmet Oyj - Director of IR***

All right. Thank you, operator. Thank you, Pasi and Kari. Thank you for the questions. This now concludes our event for today. And as a reminder, today, we also announced the Annual General Meeting will be held on June 16, and you can participate via webcast. The link will be available with the registration form on our website. And then Q2 half-year financial report will be out on July 23. So see you all then. But up until that, have a nice day.