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VALMT.HE - Q1 2017 Valmet Corp Earnings Call

EVENT DATE/TIME: APRIL 25, 2017 / 11:00AM GMT



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PRESENTATION

Calle Loikkanen - *Valmet Oyj - Director, IR*

Good afternoon, ladies and gentlemen. My name is Calle Loikkanen and I'm head of Valmet's Investor Relations. And it's my pleasure today to invite you to Valmet's Q1 2017 Results Presentation.

And today, Valmet's President and CEO Pasi Laine together with Valmet's CFO Kari Saarinen will walk us through the results presentation and the highlights of the quarter. And as always, we will end with a Q&A session.

So, without any further ado, Pasi, please, the floor is yours.

Pasi Laine - *Valmet Oyj - President, CEO*

Okay. Thank you, Calle. Welcome to this info meeting. So, first, I would like to say that our orders received increased especially in Paper business line.

So, what I want to go through today is first Q1 in brief, then something about business lines development. Kari will go through financial development, then we will have guidance and short-term market outlook and then summary.

So, Q1 2017 in brief. First of all, our orders received increased to 427 million in our stable business. Our orders received increased to 578 million in our capital business. Our net sales remained at last year's level, being at 671 million.

Our backlog increased to EUR2.6 billion. Profitability improved. Comparable EBITA margin was at 5.1% and gearing was minus 3. So, maybe the biggest news here are the very good order intake both in stable businesses and in capital businesses.

If you look the quarterly numbers. So, orders received was 1 billion and 5 million. I think it's a very good result because, Okay, we have done that twice earlier in Q1 in 2014 and Q2 2014. And then we got very big pulp mill orders. But this time, it came from Energy and Paper from smaller size of orders. So, I think this 1 billion and 5 million is very good results for orders received in one quarter.

Our net sales was 671 million, Comparable EBITA 35 million, and as I said, in percentage it was 5.1%. And we employed 12,051 people in the end of the quarter.

And here you see also in the graphs or in the pictures, the orders received by business line and like you see in this -- this pie chart, Paper was bigger than traditionally it was. So, Paper business line order intake was very good.



Stable businesses was 42% from the total order intake. And last year, as an average, it was about 50%. And like in last year, Europe continued to be a very strong market for us. So, about 50% of the orders came from European area.

Then, as a graph, the orders received and like you see two first quarters in 2014, we had big orders. And like I said, it -- the reason for them was the big pulp mill projects we got then. And now, it was 1 billion first time thereafter- like I said, without any big pulp mill projects. And of course, it's nice to see that the 12 months' cumulative curve is somewhere EUR3.3 billion level in order intake. And here, you see also -- okay. That's the same graph. So, order intake is about 50% from Europe.

Then our stable business, orders received totaled to 1 billion 567 million. And we are very pleased to show this graph where we can show that when Valmet started, our stable business being then only Services, order intake was about EUR1 billion. And now, last four months or four quarters, it has totaled to almost 1.6 billion. And I think it's a big change in three years, four years in Valmet and Valmet's business mix. And we are, of course, very happy that we were able to grow both Services and Automation also in Q1 in 2017.

Then our backlog was -- ended at EUR2.6 billion level and that's the highest backlog we have had during Valmet times. And it's almost 330 million higher than in the end of the last year. We are saying that about 70% of the order backlog is currently expected to be realized as net sales during 2017. And then, of course, when the backlog is bigger and 70% is realized and last year, it was about the same story, then it means that the backlog which will be realized in net sales this year is a lot bigger than last year.

And like, all the analysts you were commenting last time already that we have reasons to be care -- to reconsider our net sales guidance. And then, of course, now when you have seen these numbers, it's obvious that we had the reason to change our net sales guidance like we did in the end of last week.

Then, we are saying that about 25% of the order backlog is relating to stable business and of course, all the rest is related to capital business. But all in all, this backlog situation is now on very healthy level on Valmet.

Then, a couple of words about business lines development. First, Services. So, Services order intake was 355 million. There is growth of 14% compared to last year. We are saying that normally our market is growing 1 to 2%. And of course, this 14% means that the market has been active as well. It's not, of course, coming only from our own actions. So, the market has been active. But in any case, we are very satisfied with the order intake being so high, 355 million. And like you see on the trend curves here, order intake has been constantly growing now last two years, three years.

Net sales was on little bit lower side, 252 million. And there is the normal seasonality explaining why the net sales was lower than in end of the last year. Typically, our first quarter in net sales in Services is low compared to the other -- other quarters.

Then, Automation continued to grow. So, the total order intake was 88 million and we had a growth of about 10% compared to last year. And that's also a very good result and we had also growth last year in Automation business and it's nice to see that the growth continued.

In this quarter, we got 16 million internal orders in Automation. That shows also that the cooperation between Automation and the rest of the businesses is constantly improving and showing in a nice way why Automation acquisition was very relevant to our businesses. Net sales wise we ended up in 72 million in the first quarter.

In Pulp and Energy, orders were 265 million, which was a little bit higher than a year ago. And here, the change is that mainly the business is coming from Energy side. So, we have quite active boiler market and less active pulp market like we had also during 2016. Net sales wise, we were at 204 million, which was a little bit better than last year but, of course, lower than the average order intake has been.

Paper was -- I don't know which word I should use, but it was good, 314 million order intake in one quarter. And of course, you see also in the graph that it's way above the average what we have had. And there has been quite a lot of activity in paper market, both in - board, tissue and in this quarter also in paper or traditional paper machines. And this is now second consecutive quarter when we have good activity. This, of course, means that our workload in paper and tissue businesses is -- it starts to be at a very good level.



And of course, it was very nice to see the order intake development in quarter one. Net sales wise, we had 156 million in net sales and that's, let's say, like we expected also, so nothing dramatic in net sales in Paper business. But we are, of course, very happy of the Paper business line reaching that level in order intake. And like you see in this 12 months cumulative curve, Paper business line order intake over the last four quarters starts to be close to 800 million.

So, that was a quick summary of Valmet and business lines. And now, I'll let Kari to talk, go through slowly the financial development. Otherwise, we are ready in 10 minutes.

Kari Saarinen - Valmet Oyj - CFO

Yes, yes. So, as you heard, Pasi said that Paper was good and not relatively good. So, the relatively good is usually the best that he has ever said earlier.

All right. So our orders received, as said, was the highest since the beginning of 2014. So, we were at 1 billion 5 million. So, that's 25% higher than a year ago. All business line exceeded quarter one last year. And both Services business -- both Paper business line as well as Services business line actually were the highest ever at Valmet.

Also, order backlog, 2.6 billion, that was the highest quarter end with Valmet. And 70% of the order backlog will be recognized as net sales this year. So, that will be 1.8 billion. Our net sales was 3% higher and that increase actually was coming from stable business.

And then if we calculate together now our order backlog and also then the quarter one net sales for the -- so order backlog for the year and then the net sales of the -- of quarter one. So, we are 250 million higher than what we were a year ago at this stage.

Comparable EBITA, that was 5.1% or 35 million, improvement from last year's 31 million. Our EBITA was 37 million, so that was actually 2 million higher than comparable EBITA and the reason is that we booked some onetime gains during the quarter. And then EBIT was 30 million, so clearly higher than a year ago, 19 million. Cash flow was good, 94 million and gearing was now, again, negative -- minus 3%.

Okay and then looking at gross profit. So, our gross profit was -- gross profit percentage was flat and -- compared to year ago. But our gross profit was 6 million higher and that's coming from the 3% higher sales. And then our SG&As, they were slightly below last year's quarter one SG&A. So, meaning, that the SG&As we had were under control.

EBITA -- so, our quarter one EBITA is seasonally the lowest. And we are actually back on track now to be -- to exceed the previous year's quarter's EBITA. And this quarter one now was the highest quarter one EBITA that Valmet has done.

Cash flow. So, we have had now three good quarters with cash flow, around 100 million each. And then looking at last year, so last year quarter one, our cash flow was 3 million. And the main contributor for the good cash flow development is the -- it's the networking capital that has developed favorably during the past few quarters now.

And here we can see the net working capital development. So, as said last -- since last summer, our net working capital has developed very well. And the end of quarter one, now, our net working capital was minus 428 million. So, that was the best ever at Valmet times and that was minus 13% of our rolling 12 months orders. It was also -- which is also the -- like best now during Valmet times.

And then, looking at net debt. So, we -- our cash is 115 million higher than end of quarter one last year. So, we have paid out 95 million long-term debt and that actually has resulted now a situation that our gearing is negative, minus 3% of minus 27 million. And this is now the first time that our gearing is negative since the acquisition of automation.

And then also the equity to asset ratio, that improved to 37% even though we paid out 63 million dividends -- dividends now, this year. Return on comparable -- return on capital employed. So, our target is between 15 and 20% and we actually getting very close to that now. So, we are at 14% currently. And back to you, Pasi.



Pasi Laine - Valmet Oyj - President, CEO

Kari speeded up when I asked to slow down. I should have said to speed up.

Kari Saarinen - Valmet Oyj - CFO

I don't have more slides.

Pasi Laine - Valmet Oyj - President, CEO

Good. So, then guidance and market short-term outlook. Short-term market outlook. So, like said on April the 12th, we changed the guidance and now we are saying that Valmet estimates that net sales in 2017 will increase in comparison with 2016 and comparable EBITA in 2017 will increase in comparison with 2016. So, the change was in net sales.

Now, we are saying net sales is increasing. And like Kari was saying, the net sales and backlog for the year is roughly 250 million better than a year ago. And then, of course, it's self-evident that we are saying that net sales under this market situation should increase compared to last year. So, that was one change which happened on April the 12th.

Then, from the market outlook, we changed the outlook from Services from satisfactory to good. And the reason is that, first of all, our organization utilization is very good. And like you saw, order intake grew by 14%. And of course, it means that the market is good as well. So, 14% can't come only from our improvement in operation and sales efficiency. So, the market is now good in our Services business.

Automation, we keep at satisfactory level. And there is the same message than was in the beginning of last year that Pulp and paper is more active than Process and energy side. Then, in Pulp, we dropped the outlook from satisfactory to weak. And partly, it's a little bit pre-warning. So, we have still good workload in most of our units. One unit has a little bit lower workload.

But then, currently, we see that the project or sales activity is quite weak in coming three to six months. And then we wanted to already now say that we don't see quick recovery in Pulp. But of course, like you know that these things change very quickly. So -- but currently, it's better to say weak than satisfactory.

In Energy, we continue to say that the market activity is good. And of course, our workload situation in Energy -- Energy is also good at this time.

In Board and Paper, we continue to say that the market is good, like you have seen now, strong two quarters in Paper and Board. And you have seen also two strong quarters in Tissue and we still keep both of them with the outlook good. Meaning, that we have still projects where we are actively discussing with customers and meaning also that we have very good workload situation now in our Board and Paper and Tissue units.

So, these were the changes in market outlook and guidance. So all in all, our stable business increased in orders received to 427 million. In capital business, order intake was at 578 million. So, both being good numbers.

Net sales was [671] (corrected by company after the call), typical first quarter low-ish number. Backlog at a good level, 2.6 billion. EBITA margin improved and gearing was minus 3 like Kari explained to you.

So, thank you.



QUESTIONS AND ANSWERS

Calle Loikkanen - *Valmet Oyj - Director, IR*

Let's continue with questions.

So, let's first start with questions here in Keilasatama before moving over to the questions from the lines. So, do we have any questions here in Keilasatama? It seems that we don't have, so we can continue with the questions from the line, so operator, do we have any questions on the lines?

Operator

If you wish to ask a question on the phone line, please press star one on your telephone and wait for your name to be announced.

Your first question comes from the line of Manu Rimpela. Please go ahead.

Manu Rimpela - *Nordea - Analyst*

Good afternoon. Sorry for joining in a bit late. So, in case you answered this, so, I'm going to ask again. But on the Services, to start with. Can you just help us to understand why we saw such a big mismatch between the Services sales being down a couple of percentage compared to orders up double digits and then we had the 6% order growth also in the prior year? Just trying to understand that why that didn't translate into higher sales in Q1.

Kari Saarinen - *Valmet Oyj - CFO*

Well, thanks, Manu, for the question. And that's right, that orders received increased 14% and net sales came down. And last year, Services orders increased 6% but that's like seasonality within the year that with Services business and Services net sales wise, quarter one is always the lowest and we tend to recognize the sales then going further on quarter two, and second half is clearly always the highest with the Services sales. And this pattern seems to continue this year as well.

Manu Rimpela - *Nordea - Analyst*

But I guess that you have that pattern every year so that should also be reflected in the comparable number in Q1 2016. So, that doesn't explain why the sales were down 3%. Unless, I'm missing something.

Kari Saarinen - *Valmet Oyj - CFO*

Yes, but then other thing is that 2016 quarter one in Services, the comparison period, there was also quite high but as said that we did good orders received last year with Services and then also quarter one this year. So, it means that it's now at our order backlog and we will recognize that sales.

Manu Rimpela - *Nordea - Analyst*

Maybe then asking the other way around. You also mentioned in Q4 when we had no growth in Services sales that you had a tough comparable. So, is that -- are the comparables from 2016 tough for every single quarter or how should we think about it?

Because just having a hard time to understand why we have these two quarters lag with no growth or even declining Service sales when the orders are up so significantly in 2016 and now in Q1 as well.



Kari Saarinen - Valmet Oyj - CFO

But as said that this is the normal seasonality what we have with Services sales that orders come in first and then we start to book the sale -- or recognize sales then quarter two onwards.

Manu Rimpela - Nordea - Analyst

Okay. Now, that's clear. Then, on the Pulp side you mentioned that you have weaker activity for the next three to six months. How do you see that impacting profitability of the group? So obviously, you will be having lower utilization rates. What kind of impact do you see that having?

Pasi Laine - Valmet Oyj - President, CEO

So, we have still good workload in -- first of all, in Pulp and Energy, we have very good workload in Energy. And then we have received nice order also on -- okay. Now, I have to be careful because not all the customers have given OK for announcement.

But we have good workload also in recovery boilers. Where we will have some challenges is one smaller unit and we can use those engineers in other units to help with their high workload. So, I'm not seeing actually any big absorption variance issue even if the workload would go down.

Manu Rimpela - Nordea - Analyst

Okay. And then final question, how do you see the pricing environment at the moment? Are you seeing that the improved momentum is also allowing you to start raising prices in some areas and segments?

Pasi Laine - Valmet Oyj - President, CEO

A little bit traditional answer has been that we have a little bit better pricing power when we have good backlog. So now, we start to have that kind of backlog that we continue to try to push the prices up. But of course, customers have the other target and then we have competition as well. So -- but of course, in those units where we have good workload, then we try to push the prices a little bit up.

Manu Rimpela - Nordea - Analyst

Okay. And sorry, just one more final question. The order intake in Services. So, can you explain why we had such a strong order intake in the quarter, was there something specific, larger contracts or was it broad based across all regions and end markets?

Pasi Laine - Valmet Oyj - President, CEO

No, it was not coming from any specific one or two orders. It was more general activity being very good in Europe. North America was good compared to last year. China, Asia-Pacific. So, activity was good in almost all the regions in first quarter in our Services. No single orders would explain that increase.

Manu Rimpela - Nordea - Analyst

OK. No further questions. Thank you.

Operator

Thank you. Your next question on the phone line comes from the line of Johan Eliason. Please go ahead.

Johan Eliason - Kepler Cheuvreux - Analyst

Yes. Hi. This is Johan at Kepler Cheuvreux. Just a question. Your gearing is now back to net cash position. What level do you target to have there in terms of gearing considering that I think Metso just told us that they pay for their cash position right now? And then secondly, are there anything happening then on the M&A front? Thank you.

Pasi Laine - Valmet Oyj - President, CEO

We have to remember, first of all, that the cash, what we have now, doesn't belong to us or a big part of that doesn't belong to us. So, we have been getting advances from our customers.

Order intake has been good. And then always, when we have good order intake, we will get advances and then our cash position is improving. So, you cannot, in your calculation, take all the cash to be such that it belongs to us. Customers have been giving that money to -- for us to buy and produce things for them. So, it's not our cash.

Gearing was minus 20 before we acquired Automation. So, we still, of course, can go a lot of lower in gearing. And then on the M&A side, our policy is still to focus on improving the current operations and businesses and we are not that much targeting for acquisition growth.

Johan Eliason - Kepler Cheuvreux - Analyst

Okay. And then just on the -- you talked about the normal seasonality in Services -- et cetera. Does this imply that we have the normal seasonality now in terms of margin development going forward, the Q2 would be better than Q1 then the Q3 better than Q2, et cetera, or do you see any unusual pattern this year considering Pulp outlook is starting to weaken?

Pasi Laine - Valmet Oyj - President, CEO

So if I answer the Pulp and then Kari answers the rest. So, like I said earlier, so, of course, we might have some units where we have a little bit lack of work. But currently, the workload in other units is so high that I don't see any challenge in having good enough workload for our personnel currently.

Kari Saarinen - Valmet Oyj - CFO

And then, of course, we -- about the quarter. So, we can't guarantee that this pattern continues. But it has been always so that quarter one has been the weakest and from that, we have been increasing until the end of the year. And of course, that's what we are working hard now everyday here to do the same. And then we see that the order backlog is quite high now at the moment.

Johan Eliason - Kepler Cheuvreux - Analyst

Yes. Good. And in terms of quality cost, we learned about the efficient, the fourth quarter where you had the rebuild that gone wrong. Are you in any such similar discussions right now that we should be aware of?



Pasi Laine - *Valmet Oyj - President, CEO*

Last year we had this one big project which caused overruns. And then quality cost have, of course, other -- we have, of course, other sources for quality cost as well. So, quality cost has been developing better beginning of this year than last year. Then, do we have any major project where we have big disputes?

Currently, we don't have that kind of project currently ongoing. And then, of course, we work hard every day to improve our project management so that we avoid big hits in projects in the future.

Johan Eliason - *Kepler Cheuvreux - Analyst*

Okay. Thank you very much.

Operator

Thank you. Your next question comes from the line of Horace Tam. Please go ahead.

Horace Tam - *Berenberg - Analyst*

Hi. This is Horace Tam from Berenberg. Thank you very much for taking my questions. My first question is about your Service business. I mean, you have upgraded your outlook. But I mean, if you look at last two years, you have grown your -- have grew your Service order about 5 to 6%. So, do you think you'll achieve even faster growth in your order intake for Service business?

And the second question is about your margin development. I mean, what does -- how the -- I mean, obviously, Q1 has the lowest seasonality in terms of margin -- has the lowest margin in terms of -- by quarter. Do you think this further (dips) increase in margin, how management see it? Is it on track of your development or do you think there are more to be done in Q1? Thank you.

Pasi Laine - *Valmet Oyj - President, CEO*

Okay. So, Services development. So, we now increased the outlook to good. So, it's first time. And then earlier, like last year, we grew about 6% and then we were saying that we have been gaining market share because we are saying that our Services market is growing traditionally 1 to 2% a year. But currently, the activity is higher. So, market is helping us.

And of course, for one quarter, I can't say that have we been gaining further market share but we continued to push the Services so that we grow faster than the market. If market grows faster than what we have been saying earlier, then of course, we target to grow even faster. And I think we have all the tools to do achieve that goal.

Kari Saarinen - *Valmet Oyj - CFO*

Yes. And about this quarter one and that being the lowest margin. So, that's how it's usually been that quarter one is the lowest but please also note that this was the highest quarter one that we have -- Valmet has ever had EBITA percent point wise.

Horace Tam - *Berenberg - Analyst*

Thank you. But do you think there would be more room for further margin improvement? I mean, further -- currently not that enough for you to get to for full year to the lower ends of your guidance. Can you tell us what you thought about the progress of margin improvement in Q1?



Kari Saarinen - Valmet Oyj - CFO

Well, yes. The margin -- EBITA guidance is between 8 and 10% and that was actually given last summer. Long-term target, sorry. Long-term target 8 to 10% and if we think about the earlier guidance 6 to 9%. So, that was given year 2013 and we actually reached the lower part of that target year 2015. So, it took more than a year to get there.

Pasi Laine - Valmet Oyj - President, CEO

So, 8 to 10 is long-term target.

Kari Saarinen - Valmet Oyj - CFO

Yes.

Horace Tam - Berenberg - Analyst

Okay. I see. Thank you very much. Thanks.

Operator

Thank you. Your next question comes from the line of Simbre Forboye. Please go ahead. your line is open. Please go ahead.

Simbre Forboye

Yes, hi. This is Simbre Forboye from Arctic Fund Management (Inaudible - microphone inaccessible). Your growth margin --

Operator

Excuse me, sir, we can't hear your question.

Simbre Forboye

Can you hear me?

Pasi Laine - Valmet Oyj - President, CEO

Maybe.

Unidentified Participant

Okay. Hi. This is Simbre Forboye from Arctic Fund Management(Inaudible - microphone inaccessible). Given that your gross margin was more or less flat year over year. Can you elaborate on whether sharp increases in raw materials like steel during the last 12 months have had any impact?

Kari Saarinen - Valmet Oyj - CFO

Yes. The raw material prices so far have not had any major impact to our margins, no. We have noticed that there's been some increase on the prices, but so far, no impact to our profits or profitability.

Simbre Forboye

Okay. Thank you.

Operator

Thank you. Once again, if you wish to ask a question on the phone line, please press star one on your telephone.

And no further questions at this time.

Calle Loikkanen - Valmet Oyj - Director, IR

Okay. Thank you very much, operator. Now, do we have any final questions here in Keilasatama?

It seems that we don't have. So, in that case, thank you for the questions and thank you gentlemen for the answers. And that's it for today. And the Q2 results will be published then in late July. I hope to see you all back then. I wish you a really good day and rest of the week. Thank you very much.

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