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VALMT.HE - Q1 2015 Valmet Corp Earnings Call

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**Antti Suttelin** Danske Bank - Analyst

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**Sven Weier** UBS - Analyst

## PRESENTATION

**Hanna-Maria Heikkinen** - Valmet Corporation - VP - Investor Relations

Good afternoon ladies and gentlemen. Welcome to Valmet's Q1 2015 Results Briefing. My name is Hanna-Maria Heikkinen. I'm in charge of Investor Relations. Today, our CEO, Pasi Laine will first go through highlights of Q1 and development by business line.

Then, our CFO Markku Honkasalo will review the financials. After that, Pasi will go through the outlook and after that there is a possibility to ask questions. Please, Pasi.

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

OK, thank you Hanna. It's pleasant to be here again to present second time Valmet's quarter 1 results. Now it's -- is it rotating the sound? OK, so the sound is OK. Good, I have the same agenda than normally. So first Q1 results in brief, then a couple of words about the business lines development. Markku will go through the financial development. I will go through the guidance and short-term outlook and then summary in the end.

So first the summary of quarter 1 results. So, we are very happy that our orders received and net sales increased now in services business line. So, the orders received increased, the net sales increased compared to quarter 1 in 2014.

Then in capital business, our orders received decreased comparing to very high level last year and net sales increased in capital businesses. So, orders received decreased both in pulp and energy and paper business line but like I said the comparison period was very high and net sales has increased in pulp and energy and decreased in paper where I will come back later on.

Our order backlog is at good level EUR2.1 billion. It's a little bit higher than last year, so at the good level. Then our focus to improve profitability will continue and you have seen the results also now so our gross profit increased by EUR16 million compared to last year. Percent-wise, it's increased as well.

Our SG&As are under control. They grew a little bit but they include also some increases from foreign exchange rates. And our EBITA margin improved compared to last year. Our balance sheet continues to be strong. Net debt was minus EUR134 million and gearing was minus EUR17 million. And cash flow which came from operating activities was minus EUR20 million.

So if I go the numbers first through. So orders received was EUR580 million. It's down by 50% compared to last year and of course it's lower than the normal average but it's better than a couple of last -- last quarters has been. Our backlog is on a healthy level, about EUR2.1 billion

Our net sales was EUR561 million, 8% increase compared to last year. EBITA was EUR19 million. It improved a lot compared to last year and EBITA of net sales was 3.5%. And of course we have to admit that 3.5% is still under the targeted level which is 6 to 9%.

Our earnings per share was positive EUR0.05 per share. Capital -- return on capital employed was 6% and cash flow by operating activities was minus EUR20 million and gearing like I said minus EUR17 million. So, I think we can be not happy but orders received was acceptable taking into account the market activity and then we are of course happy that the backlog here is EUR2 billion, so that we can still secure good work load for our units in coming quarters as well. And of course disappointment is that, we are still below the targeted level on EBITA on these quarterly numbers.

Here are the trend lines and like we have been saying all the time it's good to look at the trend lines in our order intake. And here you see that we have two very good quarters in the beginning of Valmet and now last three months had been on lower side and the last one was the best out of three, so EUR580 million.

If you look it by business line, Services was increasing and then the capital order intake in both Pulp and Energy, and Paper business line was decreasing. Our order intake increased mainly in South America and China compared to previous year.

Then backlog, like I said backlog is EUR2.1 billion still and we are saying that 75% of the backlog is expected to be realized as net sale during this year. And we are also saying that about 25% of the total backlog is related to our services business line. So, backlog is at a healthy level currently.

Then EBITA margin, it increased compared to last quarter -- or last year's first quarter, so it was then 0.7% and EUR4 million and now it was EUR19.5 million and 3.5%. Of course, it's down compared to last quarter in 2014. We have seasonality in some of the businesses. Like in Services, usually the revenue and revenue recognition, net sales is the highest in the last quarter. So instead of comparing to Q4, I would -- I would prefer myself to compare to Q1 and then we'll see improvement.

The net sales was lower than in Q4 and the seasonality of services takes one part and then the other one is that we had very little so called [POC] milestones in Paper business line and Paper business line's revenue was only EUR97 million and that of course decreased a total revenue for Valmet as well.

We saw that already coming in November, so this was not any surprise to us and actually -- actually all the business lines were performing like we were expecting. So, this exceptionally huge amount of POC milestones in Paper business line was very well known to us already in November. So, it's nothing surprising in that one.

Then, our gross profit and SG&A. I'll start from the SG&A, so it increased a little bit. It has also EUR3 million increased to the foreign exchange rates. So if one takes that away, then I would claim that our SG&A control is still in good shape and we are controlling the SG&A cost reasonably well in the whole company.

Then gross profit increased both in euros and it increased also in percentages compared to last year. And I think that's very relevant now when analyzing our figures that I would suggest to spend a little bit of time on analyzing the gross profit development and we are -- we are on the track like we have been saying that we increase our gross profit by several actions and then we are still have been capable in improving our gross profit level both euros and in percentages compared to last year's first quarter.

And then of course, we still continue our work with our Must-Wins to improve the gross profit a little further. So, we have program ongoing where we improve our project management and we have many actions ongoing to improve our service margin as well by different kind of harmonization of processes, improving the capability of our people and of course improving our internal processes as well.

Then we have very good progress and program in our quality cost program where we first started to measure the quality cost and now we are starting to implement lean in different parts of the organization to make sure that both the quality and efficiency are improving in our operations.

The opened quality cost a little bit in our Capital Market Day and I think the good work continues there and the same is with the procurements.

So, we have good start for our procurement program and we have seen good progress in Q1 as well and there of course the first is to negotiate better contracts with our category management and then the next topic like discussed in Capital Market Days was to emphasize the engineering costs. So, that we re-designed some of the products, so that they are more and more cost effective. We have good progress there as well.



And then of course the product competitiveness is an important issue in our R&D and we have now sold if I remember correctly 9 OptiConcept M machines which are modular -- of modular design and where we can start to see benefit of modular design also. Both in taking the orders but also in delivering them with -- with improving gross margins. So progressing all the front lines in the Must-Wins what we have been saying.

Then of course, one important topic is the automation acquisition like we announced. We have completed the acquisition 1st of April. Enterprise value was EUR340 million and Automation will become the fourth business line in Valmet and we will report same kind of numbers of Automation that we are currently reporting. So Valmet will stay as one reporting segment and we will -- we will announce from Automation order -- orders received, net sales and personnel.

And Automation will be included in our - OK, January-June, so second quarter interim review. So of course the first quarter numbers are not included from Automation. All the numbers are without Automation and then starting from April to June we will report Automation as part of -- part of -- part of Valmet.

A couple of words about how it has gone. So I think the customer reaction to our acquisition has been very positive. So, what customers see that now Valmet is somehow complete, that we have process technology, we have services and we have automation from one company and it of course gives us differentiation capabilities already today but also in the future.

And my understanding is also that personnel of Automation has been very happy to join Valmet. And so we have happy customers, we have happy personnel, and I'm sure that that combination will result in benefits for our investors in the longer term.

So it has gone well, and we are very happy that we are now proud owners of Automation as well. Then, a couple words about the business lines. If I start from Services. So we had third quarter - or second quarter, in the row that we had Services growing. Growth was about 10% in order intake, and out of that part came from currency exchange rates, so the growth would have been about 4% with the constant currency rates. But in any case Services in growing comparing to the end of the last year and comparing also to beginning of last year.

Net sales usually comes a little bit behind, and so usually it goes so that net sales at the beginning of the year is a little bit less than in the latter part of the year. And like I said usually there is that kind of peak in net sales in last quarter, like last year, you easily see that highest volumes were in the last quarter.

I'm happy that our orders received is growing, and many areas of growth is coming from North America, South America, Europe, and Asia-Pacific. And only in China do we have decreasing order intake volumes. So four out of five areas are strong in Services.

So we have started to put even more emphasis on end of Q2 on Services growth. Since then we have been able to show some results also so that order intake has been growing, and that's of course result of the good work that our teams have been doing in areas and business units to make sure we are competitive in customer frontline. And I'm happy of that development.

Then our Pulp and Energy order intake was EUR138 million, and of course comparing the last year's exceptional start, the order intake was a little bit low, or it was low. The positive thing is that we haven't lost market share, so I could claim that our market share has been the same as in the earlier years. So no alarming signals there.

Net sales was EUR222 million, so it's like we expected, and of course that gave good revenue recognition and reasonable profit as well from the revenue recognition. Later on I will come back to the future and the market outlook, but I can now already say we see now more activity in pulp side.

And less activity in energy side. So we have increased our market outlook for pulp side and decreased our market outlook for energy. And in pulp side it seems that there are projects moving ahead.

One we have announced already, and that was the Metsa Fibre Aanekoski which of course is very important, and the total value was somewhere between EUR125 million and EUR150 million. That's of course a good example that the market is more active now in pulp side. Then on paper side



I think there positive thing is first of all that order intake, like you see, is somewhat EUR600 million level, when at the lowest our order intake was somewhere a little bit over EUR500 million in 2013. So now the market has picked up, so that the run rate is somewhere at EUR600 million level, and like we are saying in the market outlook, we see that the good market situation continues in paper and board and satisfactory will continue in our tissue business.

Then, one thing which affected our net sales, and also from net sales then to profitability was that our net sales was only EUR97 million from paper business line. And that came purely because we have this kind of percentage of completion method, where we recognize the revenue when some milestones have been fulfilled. And for this quarter we didn't have milestones so many and we knew that already we - and actually we tried to tell that also in Capital Markets Day very clearly to all of you that that's the situation. So and of course in the business if you have recognition only of EUR97 million then usually you have a little bit more cost fixed cost for the same period. So then of course it impacts from that perspective also in the profitability.

But we are not worried about paper's situation at all. It was purely the timing of the POC milestones which affected our results this quarter.

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

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

Okay, thank you Pasi. And good afternoon also on my behalf.

In the first quarter of 2015 we made an EBITA of EUR32 million, and then we had change in net working capital negative EUR49 million. Biggest impact came from the increase on inventories. Then we paid cash taxes, EUR2 million, and on our cash flow before investment was negative minus EUR20 million. Our investments were EUR10 million on cash flow after investment minus EUR30 million.

Depreciation in Q1 was EUR13 million so our capital expenditure was lower than depreciation.

At the end of the first quarter, we have cash and cash equivalent EUR579 million. Our interest bearing debt was EUR445 million. Thus our net debt was negative EUR134 million which turns into the gearing of minus EUR17 million. Our equity at the end of the Q1 was EUR794 million but the equity ratio was negatively impacted by the launch which we draw in order to finance automation acquisition and then also partially the dividend payment decision. It has an impact of EUR37.5 million. Our equity ratio was 34% in Q1.

And this loan portfolio of EUR445 million will be repaid in nine years time so we have a well balanced maturity structure for the loan portfolio. And this total portfolio consists from the launch from EUR147 million from European Investment Bank, EUR100 million from Scandinaviska Enskilda Banken, EUR70 million from Swedish Export Kredit and EUR95 million from Nordic Investment Bank.

Then in addition to that, we have backup facilities EUR200 million syndicated revolving credit facility which was undrawn at the end of Q1 and then EUR200 million domestic commercial paper program out of which EUR30 million was outstanding at the end of Q1. The average maturity of our long-term loans is at the end of Q1 that was 4.1 years and the average interest rate was 1.4%. Pasi?

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

Markku learns to be so quick that we have a couple of slides to him. So he may present also longer time next time. So we have possibility for improvement. So the guidance and short-term market outlook, so we have kept guidance as it has been that Valmet estimates, that including the acquisition of Process Automation Systems, net sales in 2015 will increase in comparing with 2014 and EBITA before non-recurring items in 2015 will increase in comparing with 2014. So we have kept the same guidance that we gave in February the 6th.

And then short term market outlook -- in services, we see that the market continues to be satisfactory. It is very much depending on our own actions that how we can increase our market share and can we continue to grow our services. And like I've said, we have been doing good work in areas

and in being more and more active with the customers and in business units to have more and more competitive offering and that's why we have been able to grow our services and we continue the same actions, of course, in the coming quarters.

Then pulp side, we have improved market outlook from satisfactory to good and it's because we see that there is market activity now for pulp mills. We have announced one project already with Metsa Fibre Anekoski and it's of course very important order for us and we are very happy of that. But we see that there are also some other activities in pulp and that's why we want to guide little bit that our market is now better than it was in quarter 4 and quarter 3 last year.

Then maybe I should still say that, of course, that kind of exceptional quarters what we had last year that we got very, very big orders, three out of three in the same line. So don't expect anything like that, but we will just say that the market is now more active than it has been in quarter 3 and quarter 4.

Then in the energy side, we have announced one project we, of course, negotiated with our -- we have developments with other projects as well but all in all we see that this uncertainty in energy pricing will affect our energy business. Customers will take time to analyze that what kind of energy solutions will be suitable and the decisions -- the decisions will take more time than what we are expecting in Q4. And of course now if the oil price continues to go up then maybe the situation will normalize quicker but currently we see that the market is weak compared to Q4.

Paper side, we say that board and paper continues to be good. We have also announced one project after the Q4, yes, yes, yes, yes. Yes, we have. Yes, we have and we see that there's good market activity for us. This year the market activity continues to be satisfactory.

In automation, we are saying that the market is active -- satisfactory and, of course, we have still limited access or limited view to the automation business. So, it takes a while before we understand it well enough but roughly so that pulp and paper side activities reasonably good and then on energy side it's weak and then the average of that is that the market is satisfactory to us.

So as a summary, our orders received and net sales increased in services and we are happy of that. Our orders received decreased in capital business comparing to very high level in last year and net sales increased and there one has to analyze a little bit further down Pulp and Energy have reasonable net sales and then paper had low net sale recognition and it had an impact to our profitability.

Order backlog is at reasonable level EUR2.1 billion. We were able to increase gross profit Eurowise, percentagewise, SG&A's on control, EBITA margin improved but is below the targeted level. We have strong balance sheet net -- gearing was -- gearing was minus EUR17 million and we prepared also in Q1 for the acquisition of PAS and that, of course, has some impact to our numbers as well.

So, now it's time for questions.

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## QUESTIONS AND ANSWERS

**Hanna-Maria Heikkinen** - Valmet Corporation - VP - Investor Relations

Thank you, Pasi. So, we'll start with that potential questions from Keilasatama. Do we have any questions from Keilasatama? It seems that everything was very clear in Keilasatama. So, we will continue with the international questions.

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### Operator

Can I take questions over the phone?

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**Hanna-Maria Heikkinen** - Valmet Corporation - VP - Investor Relations

Yes, please go ahead.

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**Operator**

Right. OK. This question comes from the line of Antti Suttelin from Danske Bank Please go ahead.

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**Antti Suttelin** - Danske Bank - Analyst

Thank you. A question on paper order intake when I compared the actual outcome for Q1 with the announcement you made during the quarter it seems you have a pretty large part of actual outcome that's unannounced. Why was that EUR119 million was unannounced and only EUR30 million was announced that -- a different pattern compared to the past.

That's my first question, and then secondly, could comment PAS now that you own the business. It seems that the first quarter was really, really bad so are you still happy with the decision? Are you still -- do you still speak to the 10% to 12% EBITA margin? Thanks.

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

First the paper. That was Antti, thank you, a good question. So, we are announcing the bigger line orders or bigger rebuild orders and big part of the business is coming also with smaller rebuilds, and we didn't announce them and we don't have practice to announce them. But that market has been active in quarter 1 and that's why the order intake was maybe higher than some people were expecting and that's quite normal situation in the market that we get quite a lot of small rebuilds.

And then customers don't want to publish them and they don't want to publish. If they let us to publish then they don't let us to publish the volume and then if we publish them all then it's very difficult for you to understand that what is the small one, what is the bigger one and so it's kind of trade off in publishing, you might create too high expectations and now when we haven't been publishing then maybe the expectation was a little bit on lower side. But that market has been active and we have been also successful on that market.

Then PAS, we are still very happy about the PAS acquisition and I think the longer term strategic fit is good. Like I said, we are the only one who has automation, process technology and services in one hand. Customers have reacted positively like I said personnel has reacted positively and somehow the atmosphere around Automation is positive and many customers have been saying to me that now they are getting confidence in buying from PAS or from Automation because they know that where the business landed and that the owners is the company who is developing the offering and technology in the long run. So, we are still very happy.

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**Antti Suttelin** - Danske Bank - Analyst

OK. Can you comment about the EBITA margin importance -- do you still think that it will be -- it will be 10% to 12% as it has in the past?

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

Of course not giving the guidance for that but we don't see any big change in the market environment and Metso has announced to all you have been discussing with Metso about PAS numbers and, of course, it's Metso's responsibility to comment those and we don't, of course, know the background of those numbers. But we don't see any big change in the profitability or the market for automation.

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**Antti Suttelin** - *Danske Bank - Analyst*

OK. Thank you.

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**Operator**

And the next question comes from the line of Jan Kaijala from Nordea Markets. Go ahead.

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**Jan Kaijala** - *Nordea Markets - Analyst*

Hi. This is Jan Kaijala. One question relates to this timing of the milestone payments and so forth. I mean, you have the normal seasonal pattern, like you have in general. Then you have said that Q1 will be weak. It seems that it was slightly weaker than the average normal season and pattern would have indicated.

So this leads me to the question that, do you now see within the next three or four quarters ahead if there is quarters that are likely to have relatively higher share of milestones payments or on the opposite side, will there be quarters that will be definitely low in milestones payments as you already see them now. That was my question.

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

Of course, we know currently how the backlog is being POCced like we call it but, of course, we are not giving guidance to the quarters especially now, now we gave a hint because we have the Capital Market Days but, of course, we will not give guidance to quarters but like I -- we have tried to say that sometimes we have more POCcing in a quarter and sometimes we have less POCing and then maybe it's challenging for you to know exactly what's happening and then we're -- not guidance but I would say that it takes a little bit longer on average always when analyzing our numbers and don't get too excited to any direction based on one quarter numbers only.

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**Jan Kaijala** - *Nordea Markets - Analyst*

OK. Thank you.

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**Operator**

The next question comes from the line of Sven Weier from UBS. Please go ahead.

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**Sven Weier** - *UBS - Analyst*

Yes, thank you. Two questions from my side please, the first one being on your upgraded outlook for the pulp business. Going back to your Capital Market Day's statements, I thought you were kind of underwriting the view that the outlook for the Brazilian Greenfields might have become a little bit tougher due to the turmoil in Brazil and so that's why I find it slightly surprising that you upgraded the outlook.

So, where is it that you actually regionally-wise see the strength in pulp and do you simply also see other Greenfields projects outside of Fibria and Eldorado. That's the first point and the second point which regarding of the impact of the lower oil price. We've been hearing also from the ship sector that as you know that may be at the price of 70 to 80 projects could be starting to come back. Would you also have - what are you hearing from your clients, what do they want? Do they simply want the stabilization on whatever level or is there also a kind of price level that they would feel more confident just in terms of wondering if you had some more color on this. Thank you.

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

First is these pulp cases, of course, we are not commenting on what else we will see in the pipeline except this Metsa Fibre which we have announced. There are projects where customers are developing and, of course, all the projects don't have to be total pulp mills. So, they are also rebuilds for the pulp mills and like you see -- saw in paper, sometimes they are also relevant size together.

So, I cannot comment about the Brazilian project and I can't comment about the other ones as well but currently we see that there's good enough pipeline of projects and activities in our pulp side.

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**Sven Weier** - UBS - Analyst

And then what do you see -- maybe as a quick follow up, what do you see as the reason for this increase in the activity?

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

If you looked at long-term curve of our pulp order intake, so it has been always so that that low period, it can last sometimes even a year and then a jump in order intake then it stays for a while on high level then it goes down and stays on the high side. So, that's how the market is and maybe it's -- maybe the reason behind that behavior is that our customers are trying to calculate that when is the perfect time to increase the capacity next time?

And then once the decisions have been done, then the market growth has been eaten out by the investments for 1 or 1-1/2 years and then there is no investment and then next one to gain has opportunity to enter the market with the investments so that could pay maybe the simplest explanation and quite close to the truth as well when discussing with customers. They think that who is the next one and who can announce it at the correct time to be the next one who builds a pulp mill.

Then oil pricing. I think it doesn't impact directly with our business except that it makes the energy pricing environment uncertain and, of course, our customers now have to reevaluate that how they see the energy price to develop in the future because there were so big drop in the oil price and then I think that little bit longer perspective, our offering is not competing directly in the boilers with oil and gas. So, in the longer term, the price level it doesn't have an impact but short-term it has because the change has made all the companies to evaluate their project portfolio once again.

Then in oil price has an impact to our biotechnology offering but there the order intake is of that magnitude that it doesn't actually affect Valmet's numbers directly. It's so small business still but there we see close tying decision with the oil prices.

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**Sven Weier** - UBS - Analyst

OK. Thank you.

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**Operator**

Thank you. No further questions in the telephone for now. Please continue.

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**Hanna-Maria Heikkinen** - Valmet Corporation - VP - Investor Relations

Do we have more questions from Keilasatama? If not, then I'd like thank you for the active participation. We know that this has been very hectic day for the analysts and investors with some 22 companies reporting in Helsinki.



Please remember that we will publish the Q2 report at the end of July. So, hopefully we will see you then. Thank you.

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