

Valmet Oyj

Q2 2021 Earnings Call Transcript

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P: Sven Weier;UBS Investment Bank, Research Division;Executive Director and Analyst

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Pekka Rouhiainen^ Good afternoon, ladies and gentlemen, and welcome to Valmet's Second Quarter 2021 Results Publication Webcast. My name is Pekka Rouhiainen, and I'm the Head of Investor Relations here at Valmet.

The headline for today is that during the second quarter, orders received increased to EUR 1.2 billion and the comparable EBITA increased to EUR 95 million. And today's presenters will be Pasi Laine, President and CEO; and Kari Saarinen, the CFO.

But before we start, let me just read an important notice out loud and ask everybody to pay attention to the slide. So this presentation is to discuss Valmet's Q2 2021 results. Securities' laws in the United States and in other jurisdictions restrict Valmet from discussing or disclosing information with respect to the contemplated merger with Neles Corporation. Information regarding the contemplated merger can be found at valmet.com/merger. Under the completion of the merger, Valmet and Neles will carry out their respective businesses as separate and independent companies. The merger of Valmet and Neles and the merger consideration securities have not been and will not be registered under the U.S. Securities Act of 1933 and may not be offered, sold or delivered within or into the United States, except pursuant to an applicable exemption of or in a transaction not subject to the U.S. Securities Act.

So that's all from my side. Pasi, please go ahead.

Pasi Kalevi Laine^ Okay. Thank you, Pekka. So my agenda is the traditional one, first quarter 2 in brief, then development of business lines, then some words about very major order we received from Klabin in Brazil. Financial development will be presented by Kari, and then guidance and short-term outlook will be presented by me again.

First, some highlights. So orders received increased to EUR 487 million in stable business. Our orders received in capital business increased to EUR 765 million. Net sales remained at previous year's level at EUR 943 million, and backlog in the end of

the quarter amounted to EUR 4 billion. Comparable EBITA increased to EUR 95 million, and margin was 10.1%. Gearing was -1%.

So here are the numbers and some pie charts as well. So like Pekka said, orders received was totally EUR 1.228 billion, which is very good level for Valmet. Net sales were EUR 943 million and comparable EBITA EUR 95 million and comparable EBITA 10.1%. And backlog exactly in the end of the quarter was EUR 4.019 billion. And we employed a little bit over 14,000 people in end of the quarter.

By business line, Paper represented 36% of the order intake. So Paper's strong market and strong performance continues. Pulp and Paper had a good month as well, 27% because capital businesses were so strong, then Services corresponding to 30%, then Automation 7%, and these are, of course, normally a little bit higher numbers.

Geographically, South America, due to the big contract in -- from Klabin was the biggest area, followed by Europe and China. China continued the strong performance also in quarter 2 in '21.

Then if we -- when we look at the orders received trend, now we are again with 12 months cumulative over EUR 4 billion, not at the record level but close to the record level, which we achieved quarter 1 in year 2020. So good development trend-wise. And like you see, last 2 quarters have been very strong. The earlier one, first quarter, EUR 1.3 billion, now EUR 1.2 billion. So all together, EUR 2.5 billion.

Order activity by area is little bit different compared to the quarter 2 only. So Europe, about 40%; China, strong 24%; and now South America, strong 16% as well.

In stable business, our orders received totaled to EUR 1.827 billion during the last 4 quarters, so slight increase compared to earlier 2 quarters or even 3 quarters. And that's, of course, very important for us because we have a strategic target to grow organically and with small acquisitions our stable business as much as we can. And it's, of course, nice to see that we are now at a higher level in order intake than we were a year ago by EUR 62 million.

Backlog, like I said, ended up being EUR 4.019 billion end of quarter 2. Backlog is now EUR 300 million -- over EUR 300 million higher than a quarter ago. And we are saying that about 45% of the backlog is expected to be realized as net sales during '21. And at the end of quarter 2, it was the same 45%. About 25% of the backlog is related to stable business, the rest to capital businesses. So strong backlog.

Then some words about the business lines. First, Services. So order intake is now -- was now in first half of the year EUR 756 million, so EUR 30 million improvement compared to last year. That's, of course, very good. Net sales has been growing also by EUR 11 million compared to last year, so ended up being EUR 628 million in the first 2 quarters. Market activity has improved or is good in North America, China. South America has improved. It's flat in Asia Pacific. And Europe is still having COVID impact. So Europe is the market where we haven't seen the growth in Services yet. But all in all, good development in Services. And of course, we still have COVID-related restrictions in traveling and access to customer sites. And then, of course,

graphical paper decline has continued in this year as well, which has impacted our Services order intake. But all in all, we are now in growth mode compared to last year.

Automation. Orders received totaled to EUR 239 million, so there is EUR 25 million growth compared to last year, good growth as well. Net sales hasn't been growing yet, and that's just timing. Nothing else, timing issue. We are, of course, happy that Automation has continued to grow. And even if COVID has been there, now the trend of 12 months order intake is even higher level than it has ever been. So nice development in Automation. Of course, like in Services as well, we still have some traveling restriction impacting our Automation business. But Automation has been strongly contributing to the development of Valmet during first 2 quarters of '21.

In Pulp and Energy, orders received increased to EUR 326 million in quarter 2, and it's a strong quarter again. Of course, first quarter was even stronger, but now we have 3 strong quarters in a row, which means that now the order intake graph of 12 months - - 12 last months is now close to a little bit over EUR 1.1 billion, so at a good level. Net sales has been declining a little bit. So decline. It's now EUR 469 million compared to last year's first 2 quarters, EUR 506 million. And the decline can be explained by this low order intake in third quarter in '20 and second quarter in '20. So now we are just timing-wise having a little bit lower revenue recognition than in the year before, nothing special otherwise. Then COVID, our organization has managed COVID very well. Of course, we have challenges in -- together with customers to manage COVID in all the sites where we are globally working. But our organization has been doing very good work on that respect in Pulp and Energy business.

Then Paper. Orders received in the first half of the year, EUR 803 million; last year, EUR 522 million. So very strong first half of the year. And now the 12 months cumulative curve is already at EUR 1.3 billion level. So we have a very strong beginning of the year or last year in Paper business line. Net sales has been developing nicely as well. So net sales is now in first half of the year EUR 574 million, so growth by EUR 102 million compared to last year. And like Pulp and Energy, Paper business line has managed COVID very well. So again, challenges in many places, but our organization has been doing very good job also in Paper business line to manage the growth even if COVID is active.

Then some words about the big order we got from Klabin in Brazil. So first, we got a quite similar order already in May 2019, and that project is now on execution phase. And now during the second quarter, we were very honored by Klabin selecting us to deliver next paper machine line as well. It will be very big paper machines over -- large 9-meter wide machine with annual capacity of 460,000 tonnes, and it can produce a large variety of board grades for Brazilian markets and export markets as well. We -- at the same time, we'll deliver next fiber line there, including continuous cooking G3 technology, new bleached chemi thermo mechanical pulp line, automation systems and services, some selected services for the lines as well. So we are very honored that Klabin has selected us to be the supplier of this very remarkable order in South America.

So Kari, now it's your turn.

Kari Juhani Saarinen^ All right. Thank you, Pasi, and also good afternoon on my behalf as well.

So looking at the figures. So we had a strong quarter. All the quarterly as well as the year-to-date change percentages are positive. Orders received increased 49% to EUR 1.2 billion. Very, very important is that all the business lines increased. Biggest increase coming from Paper and Pulp and Energy business lines. Paper business line more than doubled the orders from last year and Pulp and Energy was 50% above last year. Very promisingly also both Services business line as well as Automation business line, they were both growing. Services business line orders increased by 13% and Automation business line by 12% compared to a year ago.

Orders received increased in South America, Asia Pacific, China and North America, and then orders received in EMEA actually were below last year's. Order backlog was record high and reached a bit over EUR 4 billion level, and this is 15% above last year's. We are estimating that 45% of the backlog will be recognized as revenue during this year.

Quarter's net sales, EUR 943 million. This is 3% above last year's. Paper, Automation and Services business lines, they all increased. The Pulp and Energy business line reduced. Sales in China as well as in North America increased.

Quarter's comparable EBITA, that was EUR 95 million or 10.1%. This -- please note that this comparable EBITA, this does not include Valmet's share of Neles' profits.

Cash flow for the quarter, that was EUR 180 million. And gearing was -1%.

Year-to-date orders increased by 26%, driven by Paper business lines over 50% growth in the beginning of the year and also by Pulp and Energy's over 30% growth. Automation increased by 12%, and Services business line was plus 4% compared to a year ago. All -- year-to-date, all areas, except Asia Pacific, increased.

Year-to-date net sales, that increased by 3%, driven by strong Paper business line. Comparable EBITA was 9.7% or EUR 175 million after 2 1st quarters of the year, relatively good increase, as a year ago, we were at 7.4% or at EUR 128 million.

Gross profit and SG&A. So quarter's gross profit, that was 26% of net sales, meaning 3% point increase compared to a year ago. Strong sales management and also sales work, good project execution and cost control were important here. Sales mix was almost the same as year ago. Services and Automation business lines together were 44% of the sales. Last year, they were 43%.

SG&A for the quarter, 16% of net sales, the same as year ago. Some increase in the absolute number. Business activity has increased. We are following the development of SG&As, of course, very thoroughly.

And then comparable EBITA. So first quarter -- comparable EBITA for the quarter was 10.1%, and last 12 months is now at 10.8%, and first time over EUR 400 million, EUR 412 million now. We are well within our target range, 10% to 12%, but so far, we have not reached the target for a full calendar year. Important to notice here also that

stable business's net sales last 12 months end of quarter 2, it was EUR 30 million higher than end of quarter 1. So good development there as well.

Looking at cash flow. So cash flow was EUR 180 million, driven by good profitability and also a reduction of net working capital. And we have had -- we've now had 8 quarters with relatively healthy cash flow.

Net working capital, EUR -764 million, which is -18% of rolling 12 months' orders received. Net sales is low because we have received customer payments, but we have not yet recognized revenue out of those payments or invoiced the customers. If we calculate net working capital on a normal good level of -12% of rolling 12 months' orders received, the difference is around EUR 230 million to the current level.

Then looking at net debt and gearing. So net debt was EUR -9 million, gearing of -1%. So we were debt-free. We paid dividends worth of EUR 135 million during the quarter. Equity-to-asset ratio, 39%, so no major change here; end of last quarter, this was 37%, but as said, no major changes.

And then capital employed and return on capital employed. There, our target is to be above 20%. And actually return on capital employed, that remained on a good level and was 25%. Compared to capital employed a year ago, equity has increased around EUR 180 million and interest-bearing debt around EUR 130 million.

So Back to you, Pasi.

Pasi Kalevi Laine^ Thank you, Kari. So now guidance and short-term market outlook.

So guidance, we have kept the same. So Valmet estimates that net sales in '21 will increase in comparison with 2020 and comparable EBITA in 2021 will increase in comparison with 2020. So increase, increase.

Then short-term market outlook. In services, we have changed or improved the outlook from satisfactory to good/satisfactory. And satisfactory comes from the European area. All the rest, we would say that the market activity is at a good level. So improvement -- clear improvement compared to beginning of the year or end of last year.

In Automation, we have good sales activity. We have good order intake. So all the reasons to keep the market outlook at good level.

Pulp, good activity and good order intake. So all the reasons to keep the good level.

In energy, we still have a weak market situation. So we have got some orders, but we are not at the level where we have been, and that's why we keep the weak outlook as well. And then again, the same comment that we can use the same resources also in pulp recovery boiler side. So there are no issues with the organization utilization.

In board and paper market has been good. We have been winning a lot of orders, and market activity continues to be good. And tissue, it's the same. Order intake has been good, and market activity continues to be good.

So 1, 2, 3, 4, good; 1 good/satisfactory; and then 1 weak. So that's our market outlook.

Pekka Rouhiainen^ Thank you, Pasi and Kari. We will now move to the Q&A session over the telephone lines. And as a gentle reminder, this event is not to discuss the contemplated merger with Neles. So operator, I hand over to you.

+++ q-and-a

Operator^ (Operator Instructions)

Our first question comes from the line of Antti Kansanen from SEB.

Antti Kansanen^ It's Antti from SEB. First would be on the profitability and the gross margin on Q2. And Kari already mentioned that kind of the execution and all of that was good. But was there something extraordinary good or something timing related that drove the gross margin expansion? And then related to that, should we be worried of some inflationary pressures going forward regarding raw materials, components, logistics and such?

Kari Juhani Saarinen^ Well, if you're looking at the project margin or product margin, so there was nothing major there. So solid execution. And as said, good sales work, good sales management. We kept the sales -- the as-sold margins. So overall, like organization worked very well. And of course, one thing is that we have worked very, very long in order to be here. But nothing really major. And then, if you Pasi take the...

Pasi Kalevi Laine^ Well, I agree with that what Kari said and then about inflation. So of course, we see now raw material prices increasing, some raw material prices increasing and then logistics costs increasing. And we have to fight against it and then at the same time, look for other savings opportunities in our procurement. But it's clearly a topic for us in coming quarters to fight against the inflation in raw materials and logistics.

Antti Kansanen^ Okay. And then secondly, on the backlog and the structure of the backlog. You have roughly, I guess, EUR 1 billion in the stable business. So just a reminder on how much of that is -- then to be delivered on the second half? And how much is, let's say, more short cyclical something that you book in orders on second half and then also deliver before year-end? So just to get kind of the growth expectations here.

Pasi Kalevi Laine^ You mean in stable business and stable business backlog. So you can -- I think it's pretty -- it's normal distribution in -- for this year and for coming year. And then you might be able to estimate it from the same facts what we gave last year and then comparing how much book-to-bill we have been. So we mean with book-to-bill something what we booked this year and can still recognize as revenue, how much book-to-bill we were able to generate last year and then you get quite good estimate of our net sales in a stable business.

Kari Juhani Saarinen^ And maybe one thing still to notice is that our growth at Services orders, second quarter 13%. So clearly, higher growth than what we had at the first quarter. So -- and also we changed the Services outlook to good/satisfactory now. So 1 data point here.

Operator^ The next question comes from the line of Tomi Railo from DNB.

Tomi Markus Railo^ Yes. This is Tomi from DNB. Question relating to pulp activity. If you can describe a little bit what's happening in the market? And second part, would you have enough capacity to take, let's say, another one bigger order during this year?

Pasi Kalevi Laine^ So pulp activity continues, there are projects in -- especially in South America and maybe some in Asia Pacific as well, where customers are active with the bigger ones. And then, of course, smaller and medium-sized capacity addition projects in Europe and North America as well. So there is market activity. We can still take orders in, but of course, delivery time starts to be quite long. So we work hard on making sure that we have good delivery times for the cases where we are still active. And then in real life, it goes so that because in pulp mill, there are several islands, like fiber line and recovery island and then pulp dryer. The workload in each of the unit in Valmet is not the same. So actually, the delivery times are a little bit varying from unit to unit.

And then you were asking -- our capacity. I was answering to that already actually that the capacity is varying in our units. Some have a little bit more capacity to take deliveries with shorter delivery times and then the others have to propose to customers a little bit longer delivery times.

Tomi Markus Railo^ And then on the energy side, if I can ask just, in the first quarter, I think you were maybe a little bit hopeful that there could be improving activity. But have you been seeing any of that? I can see that you announced orders, but has it in a way been slower than you anticipated? And what would you see in terms of the second half activity? Would there be enough?

Pasi Kalevi Laine^ Market has been more active and there has been, let's say, from our capacity perspective enough. But then we kept it still as weak because we all remember that that unit have had also higher order intake. I think the highest order intake in a year has been about EUR 500 million, and we are not at that level. So we get enough orders to fulfill our capacity and to execute them as well. But then should we hope for higher volumes, yes, and that might not materialize this year.

Operator^ (Operator Instructions) Our next question comes from the line of Antti Suttelin from Danske Bank.

Antti Suttelin^ This is Antti. On the Services side and Klabin, I wonder how you booked the services content of the Klabin agreement. Was that a big driver of the 13% increase in Services order intake? I'm kind of trying to figure out the underlying order intake growth in Services.

Pasi Kalevi Laine^ It varies a little bit, but the spare part packages -- if it's tied with the contract -- capital contract, that will be booked at the same time. But then if there is a services agreement, then it depends on the agreement content. So I remember, Kari correct me, but it's 6 months in advance what we book the services agreement content. So Klabin had a positive impact, but I wouldn't say that this 13% were just coming from there. We have generally had more Services activity, especially in North America, and Klabin is not in North America.

Kari Juhani Saarinen^ And also in China.

Pasi Kalevi Laine^ And in China.

Antti Suttelin^ All right. So basically, you would say that the 13% is reflective of what really is going on?

Pasi Kalevi Laine^ Yes. Comparing to last year's COVID quarter.

Operator^ We have another question from Sven Weier from UBS.

Sven Weier^ I ask them one by one. The first one is on the Klabin option. I was just wondering, do you have still any other contracts where you have such options? Or was the Klabin option quite a unique situation? That's the first one.

Pasi Kalevi Laine^ We have a very good offering now for folding boxboard machines because we are a market leader in folding boxboard, and then in that board category, you need also BCTMP lines, and we have very good BCTMP offering. So that's actually not only of the kind. I think we have even announced some others where we have the same kind of setup, our BCTMP and then folding boxboard.

Sven Weier^ And so options like that are still not the -- how shall I say, the rule, right? So it is still quite an exceptional one that clients have to go for an option?

Kari Juhani Saarinen^ Well, if you, Sven, mean that in general, in our business, so do we have like -- if we have a contract, if there's an optional another contract.

Pasi Kalevi Laine^ Sometimes it happens, but no, it's not -- it happens once in a while.

Sven Weier^ Okay. The second question was just on the travel cost. I think you mentioned in Q2, some of the travel cost was coming back. I just wonder where you are in terms of the travel activity relative to the pre-pandemic and whether you really see that going back to where it was. So what's your best guess at the current stage?

Kari Juhani Saarinen^ Well, yes, quarter 2, there was some increase in the travel cost comparing to the very low level of what we had in quarter 2 last year. And then if we see the -- how the world then goes forward, so -- of course, business activity increases. There's some pent-up demand also to meet the customers, also for some like people meeting internally as well. But the question is that do we go to the levels where we were before the pandemic. So I think that in many, many ways of doing business and having internal meetings so there has been good learnings now and also

like big steps forward in how to use the electronic media, and I doubt that we go to those levels.

Pasi Kalevi Laine^ And then we all have dreamt that we can start traveling, but it seems that every month, starting of that day is further away.

Sven Weier^ Yes. Unfortunately, yes. Then you mentioned the negative impact on the Services business from the paper closures. I mean is that something you can quantify, how much that was in the quarter? Or is it kind of the historical average that you always had in the last years?

Pasi Kalevi Laine^ We have been saying that we lose EUR 10 million to EUR 20 million in order intake by -- in a year from paper machine and old pulp mill closures. And last year, it was a little bit more. But this year, no, now we're in growth mode. So this year, we haven't seen too many closures happening.

Sven Weier^ Okay. And then the final question, if I may, is just on the scrubber business. I think you mentioned in Q2, you had 0 orders. I mean we can see that the tendering activity is picking up for the new build. I mean are you only active on the retrofit side on scrubbers or also for new builds?

Pasi Kalevi Laine^ We are active on both sides, but currently, order intake has been very low in this year.

Sven Weier^ And you don't see any change in the pipeline that this is improving?

Pasi Kalevi Laine^ It might change, but then it's better to wait and see still.

Operator^ As there are no further questions, I'll hand it back to the speakers.

Pekka Rouhiainen^ Thank you for the discussions, and we will then conclude today's event here. And as a reminder, Valmet's Q3 interim report will be published on the 26th of October, but I wish everybody now a nice summer.