THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

VALMT.HE - Q1 2016 Valmet Corp Earnings Call

EVENT DATE/TIME: APRIL 27, 2016 / 1:00PM GMT





THOMSON REUTERS

## CORPORATE PARTICIPANTS

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

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

**Kari Saarinen** *Valmet Corporation - CFO*

## CONFERENCE CALL PARTICIPANTS

**Johan Eliason** *Kepler Cheuvreux - Analyst*

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

## PRESENTATION

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

Good afternoon, ladies and gentlemen, and welcome to this news conference related to Valmet's Q1 2016. My name is Hanna-Maria Heikkinen, I'm in charge of the Investor Relations. And we have also our CEO, Pasi Laine, and our CFO, Kari Saarinen here.

Valmet had a solid start for year 2016, as orders received, net sales, and also profitability increased. Today, our CEO, Pasi Laine, will first go through Q2 2016 in brief, then he will continue with business lines' development. Then our CFO, Kari Saarinen, will continue with financial development, and then Pasi will finalize with guidance and short-term market outlook.

After the presentation, there is a possibility to ask questions. Please, Pasi, it's time to start.

---

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

Thank you, Hanna-Maria. It's nice to be here again. So it's first quarter results in 2016. Like Hanna said already, we had a good start for the year. Orders received, net sales, and profitability increased.

So today, I will go through first quarter one in brief and then business lines' development like usually, then Kari will go through the financial development and I will come back then on guidance and short-term outlook. And then, of course, we will have lively questions-and-answers session in the end.

First, 2016 first quarter in brief; so we are very happy to say that our orders received and net sales increased in our stable business, and I will have later a graph of that. And at the same time, our capital businesses; both Paper, and Pulp and Energy had an increase in orders received and net sales.

We ended up with a backlog of EUR2.2 billion. Our profitability improved; it was 4.8% comparable EBITA. It's better than a year ago, but of course, it's still below the targeted level. And our net debt was EUR192 million. So one could say as a summary that Valmet had a good start for 2016.

Our orders received was EUR806 million. Our net sales was EUR652 million. Comparable EBITA was EUR31 million. And comparable EBITA was 4.8%, like I said earlier. And we employed about 12,300 people.

If you looked at by business lines, then stable businesses, so being Automation and Services together, contributed about 48% of our net sales, and capital businesses 52% of our businesses.

Geographically, Europe continued to be strong, 45% of net sales, and North America, net sales were strong as well; 24%. So traditionally, we might have had a little bit bigger share from growth countries, meaning Asia Pacific, South America and China than in this quarter, but we can, of course, be happy that the developed countries like Europe, Middle East, Africa and US have been giving so good business to us in the first quarter. So, stable and solid situation from that perspective as well.

Our orders received increased to EUR803 million in quarter one. And now, as you can see in this graph, we have had actually quite stable order intake over the last four quarters. The lowest one being EUR725 million, and the highest one being EUR803 million. So in a way, we have found a new - of course, we cannot say stable or balanced situation, but it gives quite good indication of what kind of order intake and volumes we now talk about in our businesses.

Orders received wise, Europe was strong, we booked big order in Pulp and Energy and also in paper side and services was developing well. Here, you see that North America was 13% of the orders received, and there services was performing, but then capital business had less activity than a year ago. South America, we booked one big order; good services. Asia Pacific; good services, not that much capital. And China, about normal level. So geographically, a little bit difference is between the area, but by all-in-all, good situation.

Then if we talk about our stable business; so meaning our Automation and services business together. Now when we have had Automation in our portfolio for four quarters, we can show here that if you take the orders received over the last four quarters, our orders received from the stable part of the business was EUR1.468 billion.

When Valmet started, our order intake in services was roughly at EUR1 billion, and now, because we have been able to grow our services and we made acquisition of Automation, now we can happily report that our order intake in stable businesses starts to be close to EUR1.5 billion. I think it's a big change in Valmet's performance and stability. Currently, of course, in the future as well. So we are very happy of that development.

Then backlog, currently EUR2.2 billion, a little bit better than a year ago. Of course, a year ago, we didn't have Automation in our figures, but a little bit bigger than a year ago. We say that from the backlog, the capital business is about 75% and stable business is about 25%. And we say also that about 70% of the backlog will be recognized as revenue during this year. So this should help you to estimate our current volumes as much as possible.

Then if we go to business line development; first, services, I think it's, of course, important to report and nice to report that orders received and net sales both increased in quarter one compared to last year. Our orders received was EUR313 million, which is record, actually, in the time when we have had services in this organizational setup. So we are pleased with that. Net sales was EUR257 million; a little bit better than a year ago, but still gives a good proof that we have seasonality in our services business in revenue recognition.

We had good services development order intake-wise in China, South America. We remained stable in Europe, North America and Asia Pacific. We had also a situation that mill improvements, performance parts and fabrics remained stable; [sorry] - that they increased in orders received. Rolls stayed stable, and Energy and environmental decreased compared to last year. But all-in-all, we are happy that our order intake grew to EUR313 million in the first quarter.

Then Automation; total orders received was EUR81 million. And then if you - the internal orders, we are EUR15 million, and external EUR66 million, but of course, I'm more following, actually, this total number, EUR81 million. And now, we can proudly say that this business has contributed to orders received, total orders received, now over EUR300 million in the last four quarters. And I think it shows that Automation business fits very well with us and we are capable to support Automation in good way. And as a proof of that, we can show that we've got EUR15 million orders together, so that Automation and our capital businesses made a contract together. And Automation, of course, benefitted it, but Automation benefitted also our capital business to be competitive. So I think it's good development in Automation.

And like we have been saying, usually the revenue recognition, the first quarter is lower, so it was EUR66 million and a lot less than in a quarter average last year.

Then Pulp and Energy; order intake was EUR238 million, net sales EUR181 million. And here, you also can see that we have had quite stable order intake over the last four quarters. And with that volume, we are somewhere close to EUR900 million, a little bit above EUR900 million in order intake, EUR950 million in order intake over the last four quarters. And it seems that also in that business, the high volatility is less than it used to be. And net sales, while it's EUR181 million and it's less than a year ago, but good level in any case for that business.

Then Paper; our paper business has been performing well. So order intake was EUR186 million and we have had three strong quarters in order intake in a row. Net sales grew to EUR157 million compared to last year, a lot of lower numbers. And here, I can proudly say that we have gained more market share compared to our competition in paper, board, and tissue market. I think the actions, what we have been doing over several years, have caused to a situation that our product offering is more modern and more competitive than what the competition can offer and that has created, for us, very strong market process.

Of course, we have to continue to work hard on making sure that also in future years, we are more competitive. So we are not saying that we are somehow finished with that business, but we, of course, continue to develop and work hard on that. But here we have a good development over the years.

Then we talked about in management agenda about customer excellence, leader in technology and innovation, process excellence and winning team. And I wanted to highlight a little bit what we have been doing in technology and innovation during last year. First of all, we launched new quality control product portfolio for paper and board and tissue machines from our Automation business. So, it's totally new product offering. Everything has been redesigned, we've got cost benefit, we added some new features to the offering. And we have been now very successful in launching that product offering, which we launch to the market someway in summer of 2016. And it's an example where, by investing to R&D, we can further enhance our market position.

OptiFlo is a headbox - what we can use in board-making, so it's a headbox which can make two plies with single headbox. There is water between the plies, and this makes it a lot of more cost-effective to make paper and board machines with two plies. And that's, of course, giving us cost benefit when we are offering that to our customers. And, of course, that's resulting to better market share as well.

Then for tissue mills, we developed that kind of turbine which is regaining part of the jet energy, so roughly 50% of the jet energy can be returned by that turbine. So there is a strong jet coming from the headbox, and we take 50% of that Energy back and it can be utilized in the mill. And that's, of course, reducing the Energy consumption in tissue making.

Then for Pulp mills, we have introduced that kind of polysulfide system, which can be used especially in softwood applications to improve the yield and also improve the fiber characteristic of a Pulp mill.

All these four examples show that we invested in R&D and we get from our R&D products which are further enhancing our market position, profitability and, of course, the customer performance first of all. And, of course, we continue to develop our offering from all these with all these aspects also in the future.

Then some words about Automation; still, so a year has gone, Valmet has had Automation in its portfolio for a year. Like I've been telling earlier, we are very happy with the integration. It went smoothly. It's actually difficult to think any integration which would be even smoother because a personel wanted to be a part of Valmet, we wanted them to be, and customers thought also that the system business has found the right home. And that, of course, resulted to a situation that the integration was, from management perspective, very easy.

Automation; employees have been very engaged with being part of Valmet. They had the highest engagement index to the whole Valmet when we measured, I think, in summertime. So, of course, that's very good proof that we have committed employees in Automation.

We have been bringing new products to the markets like this paper IQ, which I explained shortly. We have sold 31 packages where Pulp, Energy and Paper is selling the capital business and Automation has its Automation offering in that package. So it shows that the combination of our Automation process technology has value to our customers.

We have been talking a little bit about industrial internet to you and, of course, Automation changed our position as industrial internet company totally. So without that, we would be actually in the beginning of our development, and now we are in that kind of position that we can - we have good installed base, good technology, and now, we can think how to use that more in the future to develop our offering and operations to help our customers.

And then, of course, like I said, orders received, total orders received, has been EUR329 million. And, of course, that has been helping us to grow the Company, but also increase the share of our stable business in Valmet. So all-in-all, we are very happy that we were able to acquire Automation and that has also given good results already in first four quarters.

So now I'll ask Kari to continue with the financial development.

---

**Kari Saarinen** - *Valmet Corporation - CFO*

Thank you, Pasi, and good afternoon, everybody. So Valmet's quarter one 2016 financials. So our orders received, EUR803 million, so they were 38% higher than what we did a year ago. And all the business lines were actually higher than a year ago. So good development there.

Then looking at our order backlog; EUR2.2 billion, so that's over EUR150 million higher than what we had in the end of the year and also much higher than what we had a year ago. Out of that order backlog, 70% or more than EUR1.5 billion will be booked as revenue during this year still. Our net sales was EUR652 million. That's 16% above last year. And three out of four business lines actually exceeded the figures of last year there.

Our comparable EBITA; so nowadays we call this comparable EBITA, that's the KPI that we earlier called as EBITA before non-recurring items, so now it's comparable EBITA. So that was 4.8%, a year ago 3.5%, so we had, usually have the seasonally lower quarter one and we were able to increase from last year from 3.5% to 4.8%.

And then our cash flow, that was EUR3 million, and our gearing increased slightly to 24%. And then about the sales; so stable business, net sales increased by EUR73 million. Our services business line increased by EUR50 million, and then Automation became part of us, so EUR58 million increase there. And then the capital business lines; Pulp and Energy and Paper business line, altogether, they increased by EUR19 million.

Looking at our gross profit development; so gross profit was 3% points higher than a year ago, so at 23%. That's driven by the increase in stable business as well as also then savings and procurement and quality costs. Our SG&A's increase of EUR25 million; that is all coming from our Automation.

And then looking at our EBITA development over the quarters; so this 4.8% that we did this quarter now, that is the highest quarter one for Valmet ever. So last year, it was 3.5% and then once we started the year 2014, it was 0.7%, or EUR4 million. Last year, it was EUR19 million, and this year, it's EUR31 million.

Cash flow, EUR3 million, so a bit low figure, driven by the - like lower trade payables than what we had in the end of March. And then looking at net working capital development. So our net working capital was minus-8% rolling 12 months, so that remained at the normal level what we've had now over the time of Valmet.

Looking at our net debt and gearing; so our net debt increased from EUR178 million to EUR192 million, so a small increase there. And then our gearing increased from 21% to 24%, and actually, that is coming from the -, because we paid 52 million dividends earlier this year. And then our equity to asset ratio, 35%. So no major changes there over the past quarters.

And then looking at our return on capital employed, so comparable return of capital employed, so that actually reduced from 14% to 13% driven by the, like, seasonally, our lower quarter one EBITA.

And then Valmet will continue to focus on operational excellence, and also we'll further harmonize our processes and we will do that by renewing our ERP. And that new ERP, will actually then increase our efficiencies that we'll also then improve our data quality, and then also it will, like, reduce the amount of manual work that we are doing in the organization. And also, on top of that, we will get annual benefits worth of EUR30 million starting from year 2020.

We first do the global template and also after that, then we do the roll-out in Nordics, which is in Finland and Sweden where we have the biggest amount of users. And that, like, first phase, this global template and phase Nordics, so that will cost us EUR50 million, out of which, we actually capitalize EUR30 million and then EUR20 million we booked as expenses during the project phase, which will take three to three and a half years.

And at the moment as we speak, we are building up a strong team; around 50 professionals, and some of these new hires to Valmet and some of these are people that are coming from various parts of our organization. And then also we have a global technology partner and also global consultancy partner to help us here. And we are now - within one month, we are planning to sign a contract with the vendors. And our approach is the best practice approach, which actually means that we will utilize all over Valmet, the best practices, and only do minor changes in the global template based on the legal requirements.

So, we will have interesting times ahead of us with this and you are welcome to follow us further on. Thank you. And back to you, Pasi.

---

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

Guidance and short-term market outlook; so we stay with the same guidance as the beginning of the year except that we changed one word here - or a couple of words.

Our guidance for 2016 is that Valmet estimates that net sales in 2016 will remain at the same level with 2015, and comparable EBITA in 2016 will increase in comparison with 2015. So we are saying the same as we have been saying earlier about EBITA definition is not before non-recurring and now it's comparable EBITA.

And then short-term market outlook; in services, we see that the market continues like it has been now and we are saying that it's satisfactory. In Automation, we say the same; satisfactory, and there the reason is that in one part of the Automation, Process and Energy, we have a little bit weaker market situation. And then in Pulp and Paper, it's good. And then as an average, this is satisfactory.

Pulp and Energy; we stay with the same outlook than earlier, so satisfactory. Energy is the same [and] earlier, satisfactory. Board and paper, we still keep on good level because we see that the market activity is good and our organization workload is good as well. And tissue, we stay with satisfactory outlook like we have at the last quarter as well. So we keep the guidance the same as earlier and this guidance includes the cost from ERP, what Kari was saying, so it's no change on that respect. Another-wise we keep the same outlook than earlier.

As a summary, we say that we are very happy that our orders received and net sales-wise increased, and that has been the target of the Company and we have been successful there.

And then, of course, it's nice that orders received and net sales increased our capital business as well. And that's, of course, important in keeping our market share good, and then, of course, workload and building up the installed-base for future services growth as well.

We have good backlog, EUR2.2 billion, our profitability improved to 4.8%, but of course, it's still below the targeted level. And like Kari said, our net debt is EUR192 million. So that's briefly how quarter one went in Valmet.

---

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

Thank you, Pasi and Kari. Now, it's time for questions. We will start with the questions from Keilasatama. If we don't have any questions from Keilasatama then we will continue with the international questions.

---

## QUESTIONS AND ANSWERS

**Operator**

Johan Eliason.

---

**Johan Eliason** - *Kepler Cheuvreux - Analyst*

This Johan Eliason from Kepler Cheuvreux. I've got a question on the ERP investment. I understand that the EUR20 million you will expense now over the coming three, three and a half years, and the rest, you will capitalize and then start to depreciate down by 2020 or so.

But considering these short-term expenses, you still sort of maintain that you will be in the sort of 6% to 9%, the modern bracket also taking this extra cost into account going forward?

---

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

Like I said, this investment will not affect our guidance for 2016 results, so they are included there.

---

**Johan Eliason** - *Kepler Cheuvreux - Analyst*

And you don't see a risk for that range to be broken in the coming years down on the back of this?

---

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

No. I think you have to do the mathematics now, so if we talk about EUR20 million internal costs over three years, then it's somewhere EUR7 million, a little bit less a year. And our last year's EBITA was EUR182 million, so I think it's an important investment, a big cost, but it doesn't influence our guidance.

---

**Johan Eliason** - *Kepler Cheuvreux - Analyst*

And then you talked about the stable businesses having grown to EUR1.5 billion in turnover, but I think you still sort of need to increase that share in order to get closer to the upper-end of your margin guidance. Do you see any activities to further grow that through, for example, M&A or other actions that you are planning to take?

---

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

So, orders received was actually close to EUR1.5 million, so I think net sales is a little bit below EUR1.5 million still in the rolling 12 months. But, of course, organically, we continue to grow both businesses and that's the target.

Then we haven't said that our target setting [will] to pay between 6% to 9% is somehow depending on how big share we have from our stable businesses. So we have been saying that whatever the market is, Valmet aims to be between 6% to 9%.

---

**Johan Eliason** - *Kepler Cheuvreux - Analyst*

But coming back to the subject of the services, you have 15% market share and your equipment share is significantly above that. How can you speed up that process in gaining your fair share of the aftermarket as well?

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

I think there we are comparing two different things, so in a machine supplier market, there are not that many suppliers, and then that's why it's quite consolidated industry and that's why we have 40%.

But then in services side, we have, of course, markets where there are many players, like let's take an example; paper machine clothing business which became part of our offering when we acquired Tamfelt. So our market share is somewhere 10% over that market and the rest is divided by companies who are specialized in paper machine clothing.

So then you can't actually so easily think that if we have 40% from our capital markets that it would lead also to 40% from services market. But then to continue from that, of course, our target has to be to crow our services and we have still room to improve our services offering and improve customer closeness, improve performance of our service offering and we continue to grow with organic.

**Johan Eliason** - *Kepler Cheuvreux - Analyst*

And if I understand you correctly, this is your preferred path to do it organically, then?

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

Currently, we are focusing organic development, but you have to remember that we made quite sizable acquisition a year ago. So for our size of company to buy Automation and the enterprise value was EUR340 million and cash out, if I remember correctly, was EUR312 million. So that was, of course, very sizeable acquisition. And then, of course, now we focus on getting the benefit of that and digesting that from our balance sheet as well.

**Operator**

Antti Suttelin.

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

Could you talk about the business line profitability in the first quarter? You had 4.8% EBITA margin overall. And if, say, Automation was about breakeven, the services business should be about 10%, then it means that the rest of the business should be making losses.

Is it right to say that the Pulp and Energy business usually makes a loss in Q1 and the paper side is positive in Q1, is that something one can think of?

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

I don't know, Antti, how to answer to you, so I have to digest your question for a while. Like you know, we are not telling what's the profitability of different business lines, so I don't know where from to start to answer so the answer would make some sense.

Maybe I first confirm that Automation was positive and we wanted to make that extraordinary comment because last year, when Metso was owning it, then profitability was something different. And then we thought that we make an exception and we mentioned that Automation was positive.

But otherwise, I have to repeat what I'm usually saying, that our thinking is that all businesses have to be businesses, which means that they have to be profitable. Then, does it happen every quarter is another topic, but our aim is that capital business is also profit contributing. And maybe we have said also that was the case also last year, but quarters, I can't tell.

---

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

But if Paper and Pulp and Energy, are they about the same in Q1 or is Pulp and Energy usually weaker than paper in Q1?

---

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

I think that there in a normal case, the profitability depends on the volume not on the quarter. And I think in both businesses, you have a situation that if you have low volume then profitability usually tends to be lower. But more than that, it's very difficult, Antti, to give even better answer. Kari, have you invented anything?

---

**Kari Saarinen** - *Valmet Corporation - CFO*

Well, maybe it show that typical - you know, for capital businesses, it's not so much like what time of the year it is. But for stable business, usually, our net sales is lower in the first half of the year and then it's higher in the second half of the year. And that also then means that overall of profitability for those businesses is a bit lower in the first half than what's the full year average.

---

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

Then on the service business; you had order intake growing, I think, 6% last year on a full-year basis, and now you had 7% growth. I guess this must be because of market share gains, the underlying market cannot be growing this fast, or -

---

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

I think it's very difficult to calculate exact market shares in the services, but I think we have been gaining market share now.

---

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

It seems like that we are not getting more questions today. But thank you for the active participation. And the interim review for January-June 2016 will be published on July 28th and then we will also have our capital markets day on September 20 in Helsinki. So please put those dates to your calendar. Thank you.

---

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

Thank you, Hanna.

---