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Q2 2014 Ahlstrom Oyj Earnings Call
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C: Juho Erkheikki; Ahlstrom Oyj; Manager - Financial Communications & IR
C: Marco Levi; Ahlstrom Oyj; President, CEO
C: Sakari Ahdekivi; Ahlstrom Oyj; CFO
P: Mikael Jafs; Kepler Cheuvreux; Analyst

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C: Juho Erkheikki;Ahlstrom Oyj;Manager - Financial Communications & IR
C: Marco Levi;Ahlstrom Oyj;President, CEO
C: Sakari Ahdekivi;Ahlstrom Oyj;CFO
P: Mikael Jafs;Kepler Cheuvreux;Analyst
P: Operator;;
P: Male;;

+++ presentation
Juho Erkheikki^ Thank you, and good afternoon from Helsinki. And welcome to our Q2 2014 conference call and audio webcast. My name is Juho Erkheikki.

Today's conference call will be hosted by our President and CEO, Marco Levi and our CFO Sakari Ahdekivi.

Following the presentation, you will have a chance to ask questions. Please note that the links for the webcast and the slides are available on our website at ahlstrom.com.

So, Marco, please go ahead with your presentation.

Marco Levi^ Good afternoon to everybody. I am Marco Levi. I joined Ahlstrom June 16 of this year. 30 years in the chemical industry, glad to take this challenge and really try to improve the performance of this company Ahlstrom.

This is our agenda today. I'm going to cover second quarter, mainly on business comments and I will address the different business areas, while our CFO, Sakari will focus on financials, cash flow, debt development, income statement, balance sheet and rightsizing projects and future prospects.

Moving to the key comments of the second quarter, overall profitability of the Company has improved. Well actually driven by better cost structure at Ahlstrom.

Overall, profitability now has improved for three following quarters, quarter four 2013, Q1 and Q2 2014, naturally we have seen improvement in most of the business areas, advanced filtration, building and energy, food and transportation, filtration (inaudible) and material, better performance while we are still a bit behind in medical, mainly due to customer loss.

Right sizing program is progressing as planned, and Sakari will give you more details and more numbers about where we are today and where we expect to be, in terms of run rate in 2014 and '15.

Overall performance has also improved but in terms of product mix and overall pricing, mainly due to some choices that we have made about exiting some businesses to low margins, mainly in the area of building and energy and medical.

Overall, second quarter we had seen some low lights in terms of volumes, performance lower than planned expectations particularly in medical and building and energy.

In the next slide, you see the key figures. Sakari will give you many more details, but in a nutshell, we made EUR153 million revenue in Q2.

Operating profit, excluding NRI was EUR13.4 million, substantially better than expectations.

Overall percentage versus net sales is 5.3%, which is the best performance of Ahlstrom in the recent quarters, gearing is pretty much flat, and ROCE percentage of 5.4%.

When you look at the performance year to date in 2014, we're down in net sales mainly because of exchange rate, comparable, sales are up 0.4%, while operating profit versus last year for the first half is up 43.5%.

A few more comments about these numbers, in the quarter, [lean] net sales development slide, you see the development of our sales in millions on the euros and the adverse - the key comment about Q2 is the adverse currency effect, which is about 3%, but overall, sales in terms of comparable net sales are pretty much flat, versus the same quarter last year.

The following slide shows you our performance in the last three quarters, and you see that in the last three quarters, when you compare them to the [Q1 and] quarters in the previous period, you have the same trend, but a much better performance. This is due to our increased focus on pricing and product mix management and on cost savings, touch on cost saving and SG&A.

On the low lights, we had to suffer in Q2 out of increased energy costs, lower volumes that I have mentioned and in terms of focus unit we have seen improvement in most of the focus units, but we are far from declaring victory in the same side [moon drying non-core].

On the next slide, you see the bridge of our operating profit, excluding NRI, Q2 2014 versus Q2, 2013. And you see more than EUR5 million improvement in selling tires and product mix, and the other key positive import comes from the other costs and out of this EUR5.8 million, EUR2.5 million are related to SG&A.

On the negatives, overall volume performance and raw materials and energy, mainly driven by energy increased cost.

Moving to the business areas revenues, I want to start with advance filtration. A key observation of advance filtration when we compare quarter 2 of this year versus quarter 2 last year, is that comparable net sales have gone up 2.1%. This is due to higher sales of industrial and gas turbine applications and during second quarter, we have been successfully increasing prices, especially our smaller customers.

The negative impact has come from lower volumes than expected, a small customers in the area of laboratory and life science and high efficiency [air] applications.

Overall, operating profit, quarter to quarter, has improved for the reasons that I have mentioned.

Overall, pretty solid business in advance filtration

Building and energy, a different picture, the comparable net sales are down 4.2%. Here we're covering is the main explanation, slower than expected demand in Q2 in Europe and very tough competitive situation in China where we're covering business is growing significantly, but pricing is far from being attractive, so we elected not to pursue certain business opportunities.

A little bit on the weak side, the Russian business, which is mainly related (inaudible), but overall, we have been able to deliver an operating performance, which is slightly better than the same quarter of last year, due to our cost initiatives and improved operational efficiencies in (inaudible).

Moving to the food business unit, net sales [look] down but comparable sales are down only 0.6%. Here we have businesses that are doing much better than last year, especially in the coffee area.

Tea bags business has been pretty flat and here in the - in terms of revenue we see the negative effect of the divestment our [Carlton] conversion.

But overall, operating profit is up quarter to quarter, again SG&A, fixed cost reduction as an impact but also product mix optimization has positively impacted the performance of the food business.

Medical business is down in terms of comparable sales, 9%. This is mainly related to volumes and volumes in North America, and some warnings that we have elected to have (inaudible) [drake] products business, low profitability business.

On the other side, we're trying to target higher profit business in medical this is why we have [built] higher sales of SMS based rated and [non-products].

Overall, operating profit is down versus the second quarter of last year. Cost reduction has not been able to balance the negative effect of volume losses that I have mentioned, commenting the revenues in the medical platform.

Transportation filtration is up everywhere, comparable sales are up almost 6%. We've been able to grow volume, grow pricing, grow margin and improve our product mix, due to some credit launches.

We have some negative effect from exchange rate, mainly due to the dollar situation versus the Euro and the Brazilian operations.

Overall, operating profit is substantially higher than quarter 2 of last year, and the contribution comes from all the positives coming from pricing and lower fixed cost. We see a [EUR7.3 million] operating profit versus EUR4.6 million last year.

This was a brief summary of our operations and business unit.

Now, I pass the presentation to Sakari to go deeper in the - with the numbers.

Sakari Ahdekivi^ Thank you, Marco.

So, we move on and start with cash. Cash is important, it was positive in Q2.

The other seasonal business and Q2 is - from a profit generating point of view, our strongest quarter usually as you see from the slide, but also cash flow is generally positive in Q2, even though we do build up inventory ahead of the shutdown season during the summer in some of our factories and - but due to the high sales, the receivables also go up.

But nevertheless, we also produced positive cash flow in Q2 with maybe slightly lower working capital build up, that could have been even better.

And that takes me to the next slide, which is our quarterly development in operating working capital, so slightly up from Q1.

Seasonality is present in that, but maybe a little bit higher than what I would have liked in some areas.

And definitely, again when we approach the end of the year, we should be able to lower the working capital and get somewhere towards the number where we had it at the end of last year, which is comparable in terms of business content.

The previous quarters in 2013 are difficult to compare because they include substantial pieces of discontinued operations in them. But the real first relevant comparison point is Q4 of last year.

Then gearing -- no news here, our gearing has been around 85% since the end of last year. It was stable also compared to Q1, more or less, so we are slightly out of our target range of 50% to 80%, however as a reminder, we do hold considerable amount of Munksjo share and (inaudible) shares on the balance sheet, and they do impact our gearing and without those, we would be well within the target range.

And one more reminder on the next slide on our - on the maturity profile of our debt structure, this is just to remind the audience that we do have a bond which is maturing next year towards the end of the year. And then we have a major refinancing also coming up in 2016.

But there's nothing maturing in any - to any great extent this year.

The other thing to state about this slide is that our liquidity has remained good. There is no material change in our liquidity position, compared to the end of the previous quarter.

And moving on into the income statement, on slide 20, Marco already talked a lot about the topline, but again to recap, so comparable sales growth, 4.4%, excluding currency and divestment impacts. But maybe more interesting is to look at the gross profit, because that actually increased. And if you would calculate the gross margin, you would see that the margin in Q2 of this year was 17.9% and that's compared to 16.1% in the comparison period last year.

So, that - that's a pretty hefty margin improvement, which of course, is coming from - partly from our pricing, partly from the mix, but then also from our exercise with our cost base, because part of what we're doing in our rightsizing is also impacting the gross margin through our production, direct and indirect costs.

And I'll come back to that in the rightsizing later on in the presentation.

On the same note, when we talk about SG&A, it's very difficult, if you look at the P&L, to see where the savings are, because in the reported numbers, we have the non-recurring items imbedded and we report them in the lines where they are affected. So, if I take an example, if we reduce people in the admin area, the non-recurring item gets recorded in the admin costs.

So, to help the reader we've actually stated here on the slide what the SG&A is excluding the non-recurring items would be, and there you see that we have been able to lower the SG&As on a comparable basis by about EUR2.5 million year on year in the quarter. And that is of course, part of rightsizing or the outcome of rightsizing. And again, I'll come back to rightsizing a bit later.

So, that leads to our operating profit, excluding the non-recurring items of EUR13.4 million, which is a good increase compared to the figures of last year.

Net financial expenses look strange in the quarter, and there's an explanation to that. The Munksjo shares that we hold, we value them at market price, but we have made an accounting change in Q2, compared to Q1. In Q1, we were taking the change in the valuation through the P&L in the finance costs.

And that was giving us a fairly large positive impact in Q1. In Q2, we said that this is not really an asset held for sale, and this great volatility in our result, so we actually are now taking the impact straight to equities, so not through the P&L.

But simultaneously, we made the accounting change, we of course, had to reverse the profit that we had recorded in Q1. And that has a EUR5 million effect on the financial expense line in the quarter. So, if you exclude that, then we would be slightly lower in that financial expenses compared to the same quarter last year.

And finally, there are still some impacts if you look at the total results, including the discontinued operations on our results, even in the second quarter, which lead to the profit period - of discontinued operations being EUR9.2 million. But the important focal point is the operating profit in the continuing operations, excluding NRIs and that - that's where we have the improvement.

Then moving on to the balance sheet, again as a reminder, the market value our shareholdings in Munksjo and (inaudible) respectively would be - would have been EUR38.9 million and EUR36.7 million at the end of the quarter on June 30th. And those are in our total non-current assets.

However, coming back to the working capital, so you see here inventories are up at EUR14 million, compared to year end - mostly that is a seasonal effect, receivables, similarly EUR17 million but then the counter-balance, especially the inventory build up, the trade payables are up on the other side of the balance sheet by the same amount as the inventories.

The other major changes in the balance sheet are that we no longer have any assets classified as out for sale or liabilities for that matter. And then the equity decrease is mostly related to still some demerger effect and then the dividend distribution, which happened during the second quarter.

In the cash flow statement, in the next slide, there is growth in the EBITDA and the adjustments line at EUR9.9 million effect in discontinued operations so it's -- with that it looks a little bit more normal and easier to compare with the rest of the numbers. Some adverse effects from working capital, last year, we still got a large positive working capital from the fact that we were doing the demerger of label and processing.

The other thing to note is CapEx is low, if you compared last year clearly lower CapEx the main ongoing project and the tail end of it is still the low cover [line] in (inaudible), mostly other than that it's not a maintenance related CapEx.

And then you see in the dividends [create] in the financial - or the financing activities sector, that the dividend cash in that was a lot lower than the previous year.

Okay, so then that gets me to the rightsizing program. And here, we've sharpened our message on rightsizing to some extent, even though as such there is nothing new here. The program continues to target EUR50 million in savings, however it's very important to understand that EUR39 million of these - of this program is something that our continuing business will benefit from. And EUR11 million is in our former discontinued operations.

The other thing to - which is important to understand that not all of the EUR39 million is SG&A cost. You shouldn't expect the EUR39 million decrease SG&A costs roughly, out of the total program, two thirds are directed towards SG&A, and the rest is in other fixed and other cost areas.

The program continues to target a personnel reduction of 400 persons globally. That's not [for] change. Also, the non-recurring items remain at EUR15 million for the whole program, however some of that was already booked in 2013. And year to date, we take EUR9 million, so it means we have another EUR6 million to go. And most of that will be booked in 2014.

Where are we today? We've achieved approximately EUR27 million of cost savings, of which about EUR11 million correlates to discontinued business. So, EUR16 million is helping our continuing operations. And the way to understand that in the numbers is if we would talk about run rate, in the second quarter, in the continuing operations, our run rate savings, compared to our 2012 cost base are about EUR25 million.

And we did have some cost savings already in Q2 of last year, around EUR5 million, so roughly speaking, we're talking about EUR20 million in incremental run rate. If you divide that by four, you've got a quarterly number of EUR5 million, which hangs together with the EUR5 million that we stated earlier on in the waterfall as the improvement in our cost base, by and large.

In terms of personnel reductions, so far the figure is 285, so we are well beyond half way with the program by now, and we do aim to complete most of rightsizing before - by the end of this year.

However, some of it will run into 2015. And therefore, if the total - the full annualized impact will be in 2016. And this also relates to our SG&A target. We've said that we need to get back to an SG&A, which is 10% to 11% - between 10% and 11% of net sales. Of course, that depends a little bit how our sales develops as well, but we will reach a run rate of 10% to 11% as a - as a - this is our target run rate by the end of 2015. Again, that means 2016, we should see it in the P&L.

Okay, then finally, we will just close the presentation and the outlook for 2014 is unchanged. And sales continue to -- we expect it to land between EUR930 million and EUR1.090 billion, so somewhere in that range.

And also, our operating profit margin, excluding non-recurring items expectation remains at between 2% and 5% of net sales. Also, the investments, in terms of capital expenditure, remain at EUR50 million as an estimate for the year. And that roughly corresponds to level of depreciation in the group.

That concludes my part of the presentation. And I think we'll open up to questions.

+++ q-and-a
Juho Erkheikki^ So, thank you very much, Marco and Sakari. And we have now concluded the first part of the conference call, and are ready for your potential questions. And also, please note that you can ask questions by using the webcasting center and sending them via internet or email.

So, operator, please go ahead with the questions from the telephone lines. And we'll take a break here for a couple of minutes.

Operator^ Thank you.

(Operator Instructions)

There are presently no questions. (Operator Instructions).

Okay, we are - now have one question in the telephone queue. We have our first question from Mikael Jafs from Kepler Cheuvreux. Please go ahead, your line is open.

Mikael Jafs^ Hello...

Male^ Good afternoon...

Mikael Jafs^ ...hello, thank you. Good afternoon. Yes, I have a question regarding that the impact of US dollar on your numbers. Could you please remind us if we see a stronger US dollar versus the Euro, how does that affect your company?

Sakari Ahdekivi^ Maybe I take this one. So, if we see a stronger US dollar, then that will of course reverse some of the impact that we have today of the adverse impact on the topline. So, it - mostly the impact - currency impact is coming from the US dollar. We also have some impact from the Brazilian too - Brazilian Real and some other currencies, but the bulk of it is the US dollar.

However, on the profit line, we don't have a big currency impact...

Mikael Jafs^ Okay...

Sakari Ahdekivi^ ... it's mainly topline impact.

Mikael Jafs^ Okay. Perfect. Thank you very much.

Operator^ There are no further questions in the phone queue. (Operator Instructions).

Juho Erkheikki^ Okay. We do have an online question from [Nicolas Peconi] from [Ovia]. And, can you elaborate more on the performance of the focus units in Q2 please.

Marco Levi^ I will take this one. This is Marco Levi, Nicolas.

Overall, the focus units have shown some improvement, but I say not enough to get to breakeven. In particular, [long crew], we have acquired new additional significant business in masking tapes and volume is going help a lot improving the overall performance of long crew.

We have acquired a significant number of new customers, not very big but very profitable in [fin] side for our [PLA] products, so fin side asset utilization is increasing and as a consequence also the economics.

The other unit is [Mundra]. Mundra is mainly an issue - has been mainly an issue of improving the operational excellence and increasing volumes. We seem to be on the right path. And I will be able to provide you much a better update when I report the closure of quarter three.

Referring to Ahlstrom [brook], Ahlstrom brook as I said has improved the overall operational performance, reducing waste and this has impacted positively the bottom line on the building and energy business.

Juho Erkheikki^ Okay, thanks.

Operator, do we still have any further questions from the telephones?

Operator^ No, there are no further questions in the phone queue at this time.

Juho Erkheikki^ All right. It seems like we have no further questions at this time. So, it's time for us to thank you for listening and joining us today. And we'll hope to hear you again in October, when we are scheduled to report our Q3 2014 interim results.

So, thank you.

Sakari Ahdekivi^ Thank you. Bye, bye.

Marco Levi^ Thank you.