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AHL1V.HE - Q3 2013 Ahlstrom Oyj Earnings Conference Call

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PRESENTATION

Juho Erkheikki - *Ahlstrom Oyj - Manager, Financial Communications & IR*

Thank you and good afternoon from Helsinki. And welcome to our Third Quarter Interim Conference call and audio webcast. My name is Juho Erkheikki and today's conference call will be hosted by our President and CEO, Jan Lang, and our CFO, Seppo Parvi.

Following the presentation you will have the chance to ask questions. Please note that the links to the webcast and the slides are available on our website at ahlstrom.com. Jan, please go ahead with your presentation.

Jan Lang - *Ahlstrom Oyj - President, CEO*

Thank you and welcome from my side. What I'm going to do is -- what we are going to do is I'm going to talk first a bit -- a few words and slides about our strategy going forward that we announced here early in September. And then we will talk about the quarter after that do stay tuned if you will.

So firstly, if I move in to the strategic part where we have, at the first statement here, what our direction is, and that is that our aim is to grow with high performance product offering for clean and healthy environment, so a sustainability driven strategy and direction. I'll come back to that more in a moment.

In terms of our transformation and where we are right now, the following describes on a high level, it is, I admit, on a very high level -- our steps that we've been through here in the last few years and where we have arrived after this. So a very large [as I mentioned] program has been ongoing here for about four years which entails two main topics. One is to refocus the product portfolio, that we have to a large part completed and executed to -- based on our plan in 2009.

And secondly, under the umbrella of Ahlstrom, we have designed and built and driven also to be managed as a one company. We've come across with these tools and management behavior a common culture on which path we are also well advanced and have the basic elements to initiate.

So essentially we are half the size of the Company. We have refocused the portfolio and we believe that we have a platform now to start developing and growing the business towards the direction that we have outlined here.

In terms of the markets that we are operating in, this slide here, this picture here, trying to describe which are the customer markets that we address, and you have five of them here. At the same token, we have a number of applications that we offer today's markets served by four business areas.

Pretty much what I want to highlight here is that when you look at how we manufacture the product, is it's based on a common technology platform. So all of these customer market and applications are essentially built and -- or manufactured on a common and similar type of manufacturing.

The go-to market is -- varies somewhat from segment to segment [but] essential the business model. Except perhaps for lifestyles and medical care, there's some elements that are rather different, but overall a similar go-to market and business model [cost].

Now then in terms of what I'm going to build the future on -- following slides try to describe that. There's a number of big global megatrends that drives the world on the business today and even more in the future. We believe it is about resource scarcity, energy, and environment. It's about emerging needs in healthcare and demographics and urbanization and a number of elements in terms of availability of resources. For instance, clean water.

At the same time, we have emerging healthcare topics that allow us to play in terms of segments, and the urbanization is leading to various type of activities that also supports our agenda. So many things based on renewable materials, on efficient energy use, clean (inaudible) water, et cetera, being important.

So we will build our future based on these megatrends. Also key enablers are elements that we have talked about earlier. It is about when we talk about customer engagement, co-creation, and open innovation driven enablers. It is about technology and manufacturing platform and our unique know-how, fibers, chemistry, and materials technology. And it's the global reach with local insight that are our key enablers for our future direction.

And the following slide summarizes our direction from where we come today and this is a rather important slide. So in the left-hand side in the red bubble, you have our current business on which we can grow and develop further.

For instance -- and some of the families, product families we have listed here -- [wall] covers, leverage on life science, air, oil, and fuel filtration, et cetera. And many of these, good growth opportunity and some of them -- some have less, but certainly a good platform to grow.

However, what we decided on this is that we will focus in terms of high growth potential opportunities in three areas, three categories. One is clean water, where we have a technology that we have a high hope and I believe that we can build some meaningful new business opportunities on that business.

Second being a medical diagnostic. It's a highly interesting area which is based on a specimen collection analysis on a lateral flow type of paper diagnostic technology which we have already in house and we believe it will be a future growth of [broader] significance.

And the third one being composite. In our terms it means [mild based], energy efficient, lightweight type of composite materials for the transportation industry -- train, walls, construction business. Even in the walls industry, but also in the building industry. So buy our fibers used to manufacture composite materials with our fabrics.

So these are the selected three high growth areas, and we have been -- we've been in the process of putting resources and things in place and around these opportunities to start to aggressively develop these opportunities.

Finally, on the strategy part, we have also fine tuned and confirmed our long term financial targets that are on this last slide here. So we believe that based on our current situation and based on the initiatives that we have and have been putting in place, we believe that we can achieve a 7% operating profit level in 2016 and on the longer term basis 10%.

This will require sales from new product developed and need to use in the last three years of at least 20% and we have found a way to go to that number.

So these are the -- in summary, the long term targets based on the strategic agenda that we have outlined and this strategy will be in more detail discussed and opened up in our Capital Market Day in about a month's time.

I will then move into our quarter, Quarter Three. That certainly was not good and disappointing. From my perspective, unacceptable. Our sales, as such, was not from a volume point of view. That's bad. However, comparison [field] is not that good either in Quarter Three last year. But our financial performance was very weak and we will go into the topics that we have here, the impact with it.

So our sales in constant currencies rose by 5.4% whereas net sales rose by 0.9% only, but they were significantly impacted by exchange rate moves during the quarter. Second highlight, perhaps I mentioned, is the hybrid bond issue that we are rather satisfied with in terms of the amount and the terms that we managed to put together. There was a very good demand for this bond.

Lowlights -- markets remained rather soft. However, as that being the last couple of quarters, United -- no, North America emerging positive slight progress. However, fluctuation in our business, and particularly driven by transportation under heavy duty parts -- you've probably seen the announcement of Caterpillar here today or yesterday, that has -- is a reference as far as heavy duty is concerned and quite important for our business in transportation.

We had some operational issues that was unfortunate but quite significant for us in the quarter, and in our food and medical businesses, particular focus units struggled in the quarter -- continue to struggle in the quarter, if you will.

There are some key figures just I think I pretty much mentioned. The sales line operating profit was EUR1.5 million only gearing 74% up from a comparable quarter; however, down from -- sequentially from previous quarter.

If I then take the next slide in terms of quarter net sales development, volume's higher, selling prices are higher, (inaudible). However, adverse currency effects were negative. And operating profit driven by positive price management but not enough to cover for increased raw material energy costs. Then we had to also [break impact] of EUR1.6 million about and higher SGA.

And I think it's better to go on the next slide to see the bridge where we open up the components here. So when you look at selling product on volume, they decompensate for raw material and energy; however, that should really be compensated by selling price but we have not been -- managed to compensate it fully in terms of earnings share in the quarter.

(Inaudible) was EUR1.8 million negative, and then we have other costs which is -- a rather significant part of this is related to the demerger labor and processing where we have costs that were previously in discontinued operations, now in the continuing operations after the demerger. And also relates to the fact that we have a [too-heavy] cost structure after the demerger, which we're addressing with the -- ongoing with certain program. I'm going to come back to that in a moment.

Then by business area, short review. And that situation continues to grow; however, we had a slower growth in the quarter than previous quarters. Also partly related to the typical trend that we have in this business, first half is typically somewhat stronger than second half of the year in this business, particularly driven by life science business.

Net sales grew, excluding acquisitions, by 9.4% and the earnings include and this -- as in previous quarter, at about 13% of EBIT in the business area. So good and high profitability. And this business, referring to [mind] the strategies outline, medical business, they are not exercised and we have business already in this area particularly obtained by the acquisition of Munktell here last year.

Our building and energy business grew actually rather nicely, driven by volume. But it's also driven by better sales in wind, which is, from a mix point of view, not driving the margins positively necessarily. Also [post] to papers.

However, the lowlights in particularly the operating profit outline, (inaudible) had a EUR1.8 million impact, which -- so if you would eliminate that, which is obviously not right, but if you just for argument's sake, the overall performance, underlying performance of the business as it has in the last few quarters been improving slowly to better levels, but unfortunately we have this [sink] in the quarter.

Then the -- for the medical, it's our biggest problem child and has been for some time -- negative sales growth in the month with volumes by 5.6%. Positive is food packaging and beverage materials developing positively; however, negative impact by medical product in North America and Asia.

We have a adverse product mix and adverse currency effect that are rather significant. And then we have, in terms of impact, also in earnings the commercialization of [Lancor] that we just started a few months ago and the continued challenges in one of the plants. (Inaudible) as I many times said, we are making progress but very, very slow -- too slow.

Transportation filtration tracking good in growth. Net sales up by some 2%, very much driven by Asia, but also a decent number in Europe and North America in terms of local US dollar development. The challenges that we have had is particularly in South America and that we have not been able to fully compensate the cost implications of raw material cost in the business, and also had an impact of currency effect.

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And so quite a lot of our business here is in the countries where we have currencies being so significant, or significant currency swings here, devaluation of the real in Brazil and the Indian currency during the late part of the quarter. But the earnings improved and this is running at about the rate of 5% EBIT points in the business.

So then I give over to Seppo to talk a bit more about the numbers. Seppo?

Seppo Parvi - *Ahlstrom Oyj - CFO*

Okay. Thank you, Jan. And I start with the cost rate, net cash flow from operating activities. And the cash flow was EUR23.4 million for the quarter, which is a bit higher than for the same quarter last year, EUR22 million (inaudible). It is a good level and supported by the operating working capital development.

So on the following page, where working capital has been now reduced to EUR132.7 million level. Operating working capital has been on the focus since the increase during the first quarter of the year and it has come down nicely. So this slide shows that we still have the good (inaudible) from that focus when it comes to working capital (inaudible) but our working capital growths is already several years behind us.

But to recap (inaudible) on the working capital was about EUR20 million, but (inaudible) there's very good development of working capital. And turnover rate was 41 days and as you can see historically we have been tracking around 40, plus-minus.

On the following page, we have year-end ratio and yearend was at 74.2%, like mentioned by Jan earlier, and it came down to our range from 50% to 80%. Yearend was positively affected by the new (inaudible) hybrid bond, and also remained part of the hybrid, that we have actually today announced that we are going to pay back fully towards end of November.

It's worth to notice that even though that we mainly (inaudible) old hybrid, EUR34.5 million was included baked with it, but since they're both new and old hybrid bonds are fully settled in cash, the net effect is only 2 percentage points higher year-end (inaudible) reporting today. So these are the [pure picture] of our balance sheet at the end of the quarter. Our year-end was negatively affected by the impairment charges in the discontinued operations.

Then looking at the maturity profile of medium and long term grade facilities, no significant or major changes there, but the end of the previous quarter, I stated also earlier, maturity structure is quite healthy. The [Imex] peak maturity is coming up in 2015 and '16.

Liquidity remains at good level and goes at EUR295.7 million including cash and unused committed grade facilities at the end of the quarter. On top of that, we have ongoing (inaudible) grade facilities and cash flow overdrafts of EUR155.4 million of that.

And on the income statement and balance sheet, (inaudible) income statement and mixed sales, as Jan already mentioned, reported net sales was rather flat, but there are some good underlying trends -- higher volumes, increased selling prices and import product mix, but adverse currency effects have an effect on the imported sales.

Always best to note it's an operating profit level; however, currency effect is very small, only EUR500,000, as you saw on the inter operating profit mix, you saw previous.

Operating profit was at EUR1.5 million compared to EUR6.3 million for the same quarter. A year ago, there were no non-recurring items (inaudible) on net basis, and EUR1.1 million, a year ago. Profit and loss was (inaudible) operations was negative, EUR3.7 million compared to EUR6.4 million last -- a year ago.

And profits for the [credit] of -- reported a loss, actually was EUR21 million. It's worth to notice that the import of about EUR90 million [in payment] charges and fair valuation charges of the discontinued operations.

On the balance sheet of non-current assets, worth to notice that we have there including our shareholdings in (inaudible) EUR44 million and (inaudible) EUR34 million, so in total EUR78 million assets in the shares.

And as affected by -- as (inaudible) sale and distribution, (inaudible) with similar (inaudible) specialties which is presently in part of label and processing of the (inaudible) personnel and production lines that we have just announced that we are divesting (inaudible). And for the specialty, especially on the part of labor and processing, I said earlier, we appointed in the (inaudible) before end of this year.

Then yearend, like I said, was 24.2% end of the quarter. And like I said, when we had the hybrid fully settled, it pays around 76%, everything else being equal. And the cash flow, it's best to notice that change in net [virgin] capital was EUR13.4 million, EUR2.9 million a year ago, so good -- capital development I've mentioned earlier. And net cash on operating activities (inaudible) EUR23.2 million compared to EUR21.2 for the same period a year ago.

Investment versus intangible, intangible assets at EUR90 million (inaudible) a couple of million below the peak of the policy a year ago including wall covering materials (inaudible) in Beijing, China, and a few (inaudible) Italy. Then back to you, Jan.

Jan Lang - *Ahlstrom Oyj - President, CEO*

Okay. Thank you. Then I have just a couple of slides more. In terms of our (inaudible) program that we announced here earlier this year, that achieved a EUR35 million saving by the end of 2014, it will affect '15.

And however, noting that net affect for Ahlstrom is EUR25 million since part of the cost will be transferred to [Munksjo], is progressing to plan and achieve at quarter three. In the pipeline, EUR6 million savings, of which 2 million are at least being transferred to Munksjo.

And for this we have had no major -- no recurring (inaudible). So it is progressing to plan, aiming for the targets that we have or tracking towards the target that we have set.

Outlook for 2013 that was published September 16 is unchanged more in terms of sales and operating profits which we now expect to be between 0 and 92%. And our investments, excluding acquisitions, are estimated to EUR75 million, which a big chunk of this is related to our wall cover machine investment in China that is in its final stage of installing and is starting up in the next two weeks, the first sort of warming up the facility.

With that, I'll give over to you, Juho, to organize the questions. Thank you.

Juho Erkheikki - *Ahlstrom Oyj - Manager, Financial Communications & IR*

Thank you very much, Jan and Seppo. We have now concluded the first part of this conference call and are ready for your potential questions. Please note that you can also ask questions by writing them online.

So, operator, if you would please go ahead with the questions from the telephone lines and we'll pause here for a couple of minutes.

QUESTIONS AND ANSWERS

Operator

Certainly. (Operator Instructions) There are no questions from the phone.

Juho Erkheikki - *Ahlstrom Oyj - Manager, Financial Communications & IR*

All right. It seems like we do not have further questions at this time. So therefore, so thank you for listening to us today and let me just remind you that we have our Capital Market Day coming up next month here in Helsinki on the 21st. And we also hope to hear from you again in January when we are scheduled to report our Q4 and full year 2013 financial results. Thank you.

Seppo Parvi - *Ahlstrom Oyj - CFO*

Thank you.

Jan Lang - *Ahlstrom Oyj - President, CEO*

Thanks, everybody.
