THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

KEMIRA.HE - Q1 2019 Kemira Oyj Earnings Call

EVENT DATE/TIME: APRIL 26, 2019 / 7:30AM GMT

CORPORATE PARTICIPANTS

Jari Rosendal *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Olli Turunen *Kemira Oyj - VP of IR*

Petri Castrén *Kemira Oyj - CFO, Member of Management Board & President of Americas*

CONFERENCE CALL PARTICIPANTS

Ben Gorman *UBS Investment Bank, Research Division - Associate Analyst*

Harri Taittonen *Nordea Markets, Research Division - Senior Director & Sector Coordinator*

Panu Laitinmäki *Danske Bank Markets Equity Research - Senior Analyst*

PRESENTATION

Olli Turunen - *Kemira Oyj - VP of IR*

All right ladies and gentlemen, very warm welcome to Kemira's results presentation. My name is Olli Turunen and I am head of Investor Relations at Kemira. Kemira published strong results this morning. And let's have a deep dive into the Q1 numbers presented by our President and CEO, Jari Rosendal and our CFO, Petri Castren.

After both presentations you have a chance to ask questions here in the room and also over the webcast by typing the question to the webcast tool or over the phone.

Let's begin, Jari please go ahead.

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Thank you, Olli. Good morning to everyone. We did have a good start to the year in Q1, so let's look at how that went. So market demand during Q1 continued as good. Sales prices, which have been working on for long, long time are continuing to show momentum. And raw material prices, especially for polymers eased off at least temporarily during Q1. Hopefully, the up and down, a long-term cycle is now easing off and we enter a bit more normal variability on raw materials. There will be obviously volatility but hopefully a bit more balanced going forward.

We still expect the raw material basket to go up this year compared to last year but not as volatile as 2017 and '18 as we have seen. Our capacity utilization is good and our ongoing investment projects are progressing well.

Looking at the key financials, so organic growth 2%, and revenue at EUR 648 million, Operative EBITDA grew to EUR 95.6 million, and the margin was 14.8% from revenue. So we are nearing our mid- to long-term target window of 15% to 17%.

Obviously, the EUR 95.6 million has the IFRS 16 benefit in it of EUR 7.7 million but even if we look at apples to apples compared to last year's Q1 EUR 69 million we made this year EUR 88 million on operative EBITDA. Also EBIT grew nicely and the IFR impact -- IFRS 16 impact on EBIT is very small.

We experienced some supply disruptions during Q1, they are still ongoing. We had a minimal effect to Q1 numbers but we will have some effect to Q2 numbers and this was to polymers in Europe.

Looking at Pulp & Paper, organic growth was flat but when we take out the ECOX closure last year then the organic growth comparable basis was to 2%. Sales prices have improved, still work to do especially in the process and functional chemicals and optimizing costs to serve. And process and functional go mostly to paper making, tissue making and board making. Revenue EUR 381 million and Operative EBITDA EUR 50.7 million and at 13.3% EBITDA.

Market looking quite good. And customers have announced a lot of new investments into board machines especially in APAC. So mid- to long-term no worries on the market outlook. And APAC showed some softness in the beginning of the year. Obviously, Chinese New Year always has an effect that is hard to predict. When talking to the customers the pulp demand softened some but now during March-April volumes have recovered and then prices have recovered some also.

Then looking at Industry & Water and really a good start to the year. Solid water treatment market, oil and gas performance really good, organic growth moderated as expected to 26% that's nothing more to worry about revenue from oil and gas, EUR 62 million. We will also see the growth easing off to more normal levels in oil and gas and our capacity utilization remains on a high level.

Coagulant raw material prices will increase this year from last year but we are much better positioned to take on that challenge at this moment than we were a year ago this time. As said, polymer prices especially in Industry & Water helped a bit with new price increases kicking in, also in Pulp & Paper but also Industry & Water. In January, this raw material thing can be a temporary one.

For looking out for Q2 and Q3 and oil and gas and Industry & Water we will start the seasonal deliveries for oil sands this month. They will continue until September, October time. And that has a dilutive affect on our margins but will bring euros to the bottom line. So that's good to keep in mind. A really good start for I&W for the year EBITDA margin, operative EBITDA margin 16.8%.

As a reminder we have 4 core product lines in our portfolio bleaching, coagulants, polymers and sizing chemistries. And these have been the areas also where our main growth investments have been going and are going. So that's good to keep in mind. These 4 about 80% of our total revenue.

We have been investing into pulp. We have been investing into sizing and coagulants not so much because that's in a better situation mostly. We will be continuing with our special polymer investment in the Rotterdam area and ramped that up during the second half of the year, targeting the improvement of performance and growth in our CEOR applications in the North Sea. And our Chinese AKD wax joint venture manufacturing side is under completion. We also will ramp that up during the second half of the year. And as you might remember, in the beginning of the year, we announced the new EUR 60 million emulsion polymer capacity increase in United States. And that's mainly targeting our share market, which continues to grow in the future but can be utilized in water treatment and pulp and paper applications also.

That's in short, Q1. So looking at the focus areas for this year we continue to work on the sales prices. We are not there in every pocket yet. So we have to -- have to catch up and especially in paper, tissue and board, process and functional chemicals we still have work to do. We have gained some ground but work to do.

We continue to optimize our capacity allocation to best products and best paying customers. We also continue to shape and improve our own operational performance and how we service the customers. That the service cost is on right level taking care -- well care of the customers. And we continue to work on the investments that we have ongoing. There are uncertainties Brexits and trade wars out there and all kinds of things, we haven't seen the effects yet but obviously we are following how the world goes and keep a good control on our fixed cost. But all in all I am pleased how the year has started.

Next I will ask Petri to come over and talk more about the Q1 numbers and details.

Petri Castrén - *Kemira Oyj - CFO, Member of Management Board & President of Americas*

Very good, thank you Jari. So obviously, a great start to the year, particularly in Industry & Water segment had a great record quarter. So let's start and take a look at what are the key drivers behind the numbers. 6% top line growth, 2% organic growth was driven really by sales prices as Jari was talking about. We have a contract rolling out throughout the year but perhaps a higher proportion of those contracts are actually coinciding with the calendar year. And we have been quite successful in implementing the price increases for these contracts.

And this is particularly in I&W and [both] covering the polymer customers as well as customers who buy primarily coagulant products from us. We have given up some volume, you see the negative volume growth there. And this has really been conscious strategy as the focus has been on value rather than volume. And mostly the lost business has come with margins that are below average profitability.

And so we are not overly concerned about this and this is not really a market development but rather a -- like Jari was saying we continue to see a good market.

Operative EBITDA bridge, now this shows the magnitude, net sales impact of EUR 24 million, which is the raw material cost inflation versus the price increases that we have been able to implement. Obviously, a great outcome for Q1. In this context, I think it's fair to remind that Q1 last year was a really difficult quarter. We had a very severe raw material price inflation in Q1, also we had severe winter weather in North America, which actually increased the electricity costs dramatically and even we had to shut down our plants in some areas for a few days. So relatively easy comparison in Q1, but nevertheless this should not take away anything from the huge improvement that we made in Q1.

Comment on currencies. I think there is â€"- this shows that there is a tendency to revert to the mean. Last year, first half was really difficult Q1 also. And now we had a positive impact of EUR 6 million on the EBITDA line. The impact is perhaps a bit more than that many expected and really it is because our North American U.S. dollar-based business is now performing really well, not just oil and gas, but also Pulp & Paper in North America was performing very well in the quarter as well as our water treatment business in North America. So all of that is actually helping and once we convert this dollar earnings to euros now the currency impact is relatively significant.

Final comment on this page relates to the IFRS accounting change. Jari already talked about the EUR 7.7 million improvement. Again this is pretty much in line with the 1% guidance that we gave last time we talked about this. And also this year we promised that as we are not restating our 2018 numbers, we are giving this IFRS bridge, so that you can see the apples-to-apples comparison. And this comparison now shows EUR 18.5 million of improvement ignoring the impact of the accounting change.

Raw materials, I think I already covered the highlights which typically I spent time on the right hand side of this chart. But I just remind on the left â€"- about the left hand side of the chart that how to read this. So as long as the points in the charts are above zero line, we see, continue to see raw materials going up and we continue to see price increases going through. Clearly the base is however moderating. And in Q1, in particularly, there was a period when we saw the oil-based raw materials that go into the polymer products actually declining and clearly that benefited particularly our I&W business, which is predominantly -- or has a higher share of polymer business.

But I guess it's fair to say that for the short-term Q2 looks also relatively benign regarding, in a big picture, regarding raw material price inflation.

Still almost with the same breadth, I want to remind that we have seen oil price picking up really in the recent weeks. And so that's a fair reminder that we may see a continuing inflationary pressures coming back and sort of reversal to the trend that we have seen lately.

Regarding cash flow, improved profitability of course helped Q1 cash generation. And again a bit of a reminder, we have this seasonality aspect in our cash flow and Q1 typically we have a net working capital build up in Q1. This year it's sort of exaggerated with the oil sands business, where we have a sort of a -â€" we have a summer season when we are actually selling to the Canadian oil sands. However, we continue to build up inventories for this season throughout the year. So we're right about now, we're at the peak inventory level of finished products that go into the Canadian oil sands. We also have a sort of a natural seasonal side of the payable side reducing in Q1.

There was also a one particular item in regarding cash flow that I want to bring up, it's the EUR 15 million return of capital from our pension fund. It is a supplementary pension fund in Finland, fund that was already closed in 1991 for our new members. So it is in a runoff phase and it has some excess capital right now and we took some EUR 15 million back this year of this excess capital.

Finally on CapEx, a reminder that our CapEx guidance of EUR 180 million to EUR 220 million is clearly higher than the CapEx of 2018. And we have -- a number of these sizable expansion projects that Jari was talking about. And while Q1 CapEx spend was not really at the rate that our guidance is. So I just want to remind that we will pick-up the capital spend towards the end of the year or towards -- as the year goes, so we standby with that guidance.

Few comments on ratios, so operative return on capital improved now above 10% and really driven by Industry & Water profit improvement.

Regarding our reported debt. The IFRS 16 impact was to increase net debt by EUR 129 million on a comparable apples-to-apples comparison actually the debt would have come down. The net debt ratio, as we report, increased to 2.4 and again accounting standard here has a sort of a side effect that it exaggerates this as we obviously take the last period debt level, but then when we look at the trailing 12 months of EBITDA contribution, we only have 1 quarter benefiting the IFRS 16 EBITDA, which is higher and 3 quarters of straight pre-IFRS 16, if you will, numbers. And therefore we give you the sort of a benefit that its 2.1 turn would be the comparable number with pre-IFRS 16 data.

And finally, outlook. No drama, no change here. Just repeating our guidance for the year. Our year-to-date performance like I mentioned is ahead of the last year by EUR 18.5 million on a comparable basis excluding the IFRS 16 change.

With that, I think I'll stop my remarks. And we're ready to turn to the Q&A session. Thank you.

QUESTIONS AND ANSWERS

Olli Turunen - *Kemira Oyj - VP of IR*

Very good. Let's take questions first here in the room. And there is a question from Panu Laitinmaki.

Panu Laitinmäki - *Danske Bank Markets Equity Research - Senior Analyst*

It's Panu Laitinmaki from Danske Bank. I would have a couple of questions. Firstly on the pricing, which was a key driver of your earnings in Q1. And just trying to figure out if you've got EUR 34 million benefit from that in Q1 how much would it be going forward? You probably won't give me a number, but just kind of could you comment on what is happening in pricing in your 3 segments. And then also in the Industry & Water, how did that split between oil and gas and the kind of water treatment business in Q1? That's the first one.

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Well actually if you look at sequential quarters, we've been step-by-step increasing. And so this is not a 1 quarter miracle in a sense, but second half of last year, our operative EBITDA was 13%. And then when you add the IFRS 16 1% on top of that we were 14%, and now we were 14.8%. So not that significant jump, but a jump to go the right direction. If you also look at the bridge, EUR 11 million of increase of raw material so, tells the story. So we've been able to take over EUR 30 million prices up and that was desperately needed. But it wasn't this quarter that made it happen. So something like this continues, but obviously price increases in some areas are coming now to the peak and we start to look at the market especially on polymers is some area where we need to be careful, coagulants we still need to work hard. Whereas the price split, of course, in I&W we don't give that out that information but oil and gas business is mostly polymers. So we had good development the last 9 months in that area.

Panu Laitinmäki - *Danske Bank Markets Equity Research - Senior Analyst*

My second question would be on the raw material outlook. And we know that oil price has recovered but then the propylene price seems to be still weak and that probably should be good for you. So can you give anymore comments on the kind of -- you said that Q2 still looks good but what should we think about kind of the rest of the year with this oil place volatility and so on?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Well hopefully, now the sort of peaks and downs have eased off. So it's percentage points that we see movement. But I wouldn't focus only on polymer based raw materials that's less than EUR 600 million revenue for us annually. So there is EUR 1.8 billion of other products out there so we need to look at that basket. As we have said this year raw material basket on average we expect it to be a bit higher than last year average was. But we are in much better position now to take that challenge on and rolling that into the prices as the game goes forward.

Panu Laitinmäki - *Danske Bank Markets Equity Research - Senior Analyst*

All right, then a question on the sales growth in Pulp & Paper, which was lower than we were expecting because you exited this business. But I understood that you will be using this capacity to produce other products. So what you kind of see your acceleration in the growth in the coming quarters or how should we think of this?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Well, that was the 1 component on the operative EBITDA and EBIT improvement in Pulp & Paper. So we took volumes down by 2/3 in that business and kept 1/3 but the yield is totally different and some fixed cost was out. We've been doing similar type of things elsewhere. We have been capacity limited in some areas, so if we can get prices through we might lose a business semi-intentionally. And that takes capacity utilization down but then we have possibilities to offer that same capacity later to new customers. So like Petri was explaining it's value of a volume at the moment. And so picking and choosing which fights we want to win with our limited capacity.

Panu Laitinmäki - *Danske Bank Markets Equity Research - Senior Analyst*

My final question is on the earnings contribution from the joint venture and the investments that you are making. Can you comment on those? Like what happens after Q1 during this year?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Q1 this year those investments, so the specialty polymer line in Rotterdam area will come line second half of this year. We start ramping up Q3, everything going well. Not much contribution to this year, a full contribution to next year. Same thing for the sizing plant in China, for AKD wax, ramping up Q3 and then a very little contribution in Q4, full contribution next year.

Olli Turunen - *Kemira Oyj - VP of IR*

There are actually a couple of question from Anssi Kiviniemi from SEB. So I will tell them here. Anssi is asking could you give some kind of indication on sustainability of the profitability in Industry & Water. If we go back Industry & Water margins have never been close to Q1 level. Also taking into account municipal and industrial and oil and gas history, should we expect similar positive trend in group price versus variable cost spread going forward (EUR 20 million spread in Q1].

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Well it's good to remember that why we are making now the progress we have wanted to make it's been systematic work for over 1 year and its coming in quarter-by-quarter. And if you look at sequential quarters you can see that. We have had 2 really terrible Q1s last previous 2 years so we've start -- had a bad start to the year and now we had a better start to the year. So the comparison is pretty easy. The 16.8% is at the high end of our 15% to 17% window. And as we now start the oil sands deliveries through Q2 and Q3 we will see some dilution in the margins but we will see a positive impact on the bottom line from that business. And when you refer to oil and gas we actually had oil and mining also in there and we had other industry so it's not really comparable but we are coming back to the 2013-'14 levels and above that in our oil and gas profitability. And obviously '15 and '16 and '17 and part of '18 was a mess because of the oil cycle that we saw.

Olli Turunen - *Kemira Oyj - VP of IR*

And then the question from Anssi Kiviniemi is in early 2019 you saw the raw material price inflation perhaps somewhere at mid-single digit territory. Is this still your view or are you seeing more pressure on oil price driven raw material basket?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Hard to predict because there is couple of things there is the oil and gas market price, natural gas market price, then there is the propylene price development which is a -- comes from the feedstock but also supply demand balances driving that. And now we have had truly some serious availability issues of Acrylonitrile because of some supplier plant breakdowns and we are at FM at the moment. So there are so many components there but I think the big cycle is over. Now we will see moderate moves one way or the other.

Olli Turunen - *Kemira Oyj - VP of IR*

Then the third question is quick and easy. What was the IFRS 16 impact on free cash flow in Q1 versus Q1 2018 and the answer is EUR 7 million. Operator, let's take questions over the phone.

Operator

(Operator Instructions). Our first question comes from the line of Ben Gorman from UBS.

Ben Gorman - *UBS Investment Bank, Research Division - Associate Analyst*

And 2 quick questions (inaudible). One and on that and the expansions over the course of this year on [solvent] recovery and AKD. And what do you expect in terms of a headwind to the EBITDA line and you are going through this year and next year on those? And also the U.S. plant you are planning to build as well? And if you can do so clarify that the headwind to (inaudible) in short terms now. And secondly, and I know it's very early days and have you seen any tangible changes in the market yet from the BASF and Solenis integration maybe just and price behavior maybe and those are (inaudible).

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

It was breaking up a bit but hopefully we caught everything. So the market competition situation behaving pretty much like we -- everyone is using the same raw materials, so similar behavior. I won't comment the BASF Solenis situation but remains to be seen how they behave in the markets. Everyone is announcing price increases as you can see. And we obviously want to be in the lead also in that so that's what's happening. To the EBITDA from the ongoing investments, I think there is not much negative or positive impact. Some positive in Q4 from the Rotterdam and from the Chinese investments as we get them ramped up but only a small positive. And on the cost side they are still in CapEx phase. So that's the main situation. Did I miss something?

Petri Castrén - *Kemira Oyj - CFO, Member of Management Board & President of Americas*

Yes, if I just continue you are absolutely right on EBITDA level and I think Ben's question was on an EBITDA level, no headwind. But I would like to use the point of reminding that we have started depreciation on the AKD plant in China and we are already amortizing the purchase price for the Chinese joint venture. So on EBIT line there is a clear negative on 2019 and this will turn to positive then once the plant is fully up and running and starts to contribute under EBITDA line like Jari was talking about, from Q4 onwards. So this is partially explaining the dilutionary impact in Pulp & Paper EBIT line.

Operator

And the next question comes from the line of Harri Taittonen from Nordea.

Harri Taittonen - *Nordea Markets, Research Division - Senior Director & Sector Coordinator*

Just 1 question. You talk quite often say there is a little of that volume to -- from volume to value base that (inaudible) and that seems to work. So I'm just wondering if you could explain a bit or how -- has there been any kind of a clear change in [building] the organization or how do you measure it? Or how do you concrete these changes or I mean what could you say about that?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

It's a very concrete and it's been ongoing for over a year, but as we look at the mass of annual contracts that we have it grows gradually until we start getting momentum of more than half of contracts renewed. So basically, what we're saying that we go into bids in a way that, that if we don't get our prices we're ready sometimes to walk away. And especially we've been applying that a lot in Industry & Water North America, where significant price increases, I mean, big double-digit the price increases have been introduced. And that's the way the market continues. And sometimes we lose a bit of volume, but it's not worth keeping it at a bad price.

Harri Taittonen - *Nordea Markets, Research Division - Senior Director & Sector Coordinator*

Okay, okay. And then very [recently] there has been some of the [forest] companies suggesting that well in their efforts to cut costs, I mean there could be kind of working to [renewables] shed some of their chemicals contracts. And so there is obviously it's an ongoing and -- a theme which happens all the time obviously do you see that sort of happening particularly forcefully at the moment or not?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Well, it's obviously a delicate balance and negotiations are negotiations. But if the customers are listening to that, you didn't let us raise the prices. So I'm not about to drop them now.

Operator

(Operator Instructions)

Olli Turunen - *Kemira Oyj - VP of IR*

Meanwhile let's take a question here from Petri Gostowski, Inderes. He is asking, there are indications of short-term oil supply in caustic soda market and possibly pressures on prices. Do you share this view? And how do you see this affecting Kemira?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Well the prices have come from excellent to good in the market. And we only sell, and produce, and trade caustic in the Nordics. So the Nordic prices are still totally different from the Central European or U.S. prices, where we don't even sell caustic. We produce about 20% of the caustic what we sell. So we trade the rest. So it's a cost plus business in a sense for us. So I don't see a big impact on that. And our self made caustic is very sought after in the Nordics.

Olli Turunen - *Kemira Oyj - VP of IR*

That's clear. There are no further questions. So this concludes the complete Q1 session. Thank you for your participation, and have a good day. Thank you.

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Thank you.

THOMSON REUTERS