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Preliminary Q3 2019 Nilfisk Holding A/S Earnings and Adjusted Full-Year Guidance for 2019 Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Nilfisk Update Conference Call. (Operator Instructions) I must advise you that this conference is being recorded today, Wednesday, the 16th of October 2019.

I would now like to hand the conference over to your speaker today, Hans Henrik Lund. Please go ahead.

Hans Henrik Lund ***Nilfisk Holding A/S - CEO & Member of Executive Management Board***

Thank you, operator, and thank you for attending our update call this morning and sorry to keep you waiting for a couple of minutes. Obviously, a quarter -- Q3, that was disappointing to us, and we would like to walk you through the main facts first and then do some deep dives on each region and gross profit and EBITDA and how it developed, and then we will come back and talk about what it means to our full year guidance.

So if you allow me to kick off with the hard facts, we had a branded professional business that shrunk by minus 4.7% in Q3, a drop that was mainly caused out of EMEA, and I'll come back to that. The total business was down by as much as 6.8%. Private label was an important factor in that, and we will come back to that as well.

Growth margin, 41.5%, somewhat impacted by capacity utilization. However, still better than the year before.

On the overhead costs, 34.3%. We have obviously tried to reduce our overhead through the quarter, but obviously not enough to compensate for the large drop in revenue, and that leaves us with an EBITDA before special items of 7.2%.

Let's dive into the regions and to the best of our ability give you a growth to what we see. In Q3 -- through Q3, we saw a drop mainly originating out of Germany. So basically, the conditions in Germany did weaken macro economically. And you're reading the same things we are and you're seeing the same statistics and data that we are, so that's a given. That has impacted our business in Germany itself. And through Q3, we also saw a spillover to some of the other countries, starting really with the gas region, so going into Austria, Switzerland. We saw a spread also into neighboring countries in the former Eastern European countries. So basically, a deepening of the situation in the Central region.

Not only did we see that, we also saw a weakening of the industrial segment in general, mostly impacting us in the South region, France, in Italy and Spain, which is brought that region down to a negative growth as well of a fairly significant number.

In the North, we haven't seen yet. That's been more stable versus Q2. And in U.K., we still see a positive development not as much as we start early in the year, but still a positive number. And of course, that's prior to what we know will happen to hard Brexit or not.

So in summary, it got worse in Central Europe. It is spreading in the industrial segments down South. In the North, we're not seeing a major impact yet. It's the same level more or less that we saw in Q2. So that's really in there. And if you look at the whole thing when we come to how we look at Q3 and Q4, 60%, 70% of what we see is caused by that situation in EMEA, and we're not seeing that improve short term. So that's EMEA.

If we then move on to our North America, that's where I'm personally most annoyed and disappointed because we've had 3 quarters where we're growing. We didn't manage to do the fourth quarter in a row, and that's, of course, annoying. And we had promised that we would grow more second half than first half. What we see now, that ain't going to happen. And if we break it down, we probably missed by about EUR 3 million, EUR 4 million in Q3. The majority of that is driven out of our U.S. high pressure washer business. Two things, the Agri segment has been slow for us in Q3, and then we had a bankruptcy of a fairly large dealer that has impacted us well. So the majority comes from there.

Then if you look at the remaining part of the U.S. business, we are executing on the plan. In Q3, Q4, we are seeing less than the expected pickup, especially in the Industrial segment. We've had 1 dealer who is buying less this year than we expected up until August, and that is hitting us.

In general, I would say we're doing the right things in the U.S. We're focusing on increased demand generation. That means we have sales guys out there. They have to do 44 end user business a month. We're tracking it on personal level. It's part of how we evaluate them. We are increasing our marketing efforts, so the demand creation is moving in the right direction. We are focusing on the biggest potentials in the state, and we're moving salespeople around to make sure that we cover the right territories. We are, in some cases, adding distribution to be fully covered on our white costs. So that's taking place as well. And finally, we are, of course, operating the sales force with training in selling the full portfolio, and we have attracted new talents for the year.

So the plan we've made, we're still fully committed to. We have to admit that it was a curve ball, what happened to the high pressure washer business. And it is going a bit slower than we had anticipated, especially in the industrial segment and partly in the national accounts. What I'm also saying with that is that what we see in our commercial segment, the underlying growth in that we acquired and content with.

So that is the situation in the U.S.

If we then move to APAC, another disappointing quarter for APAC. Reality is that we've not yet seen Australia improve as expected. We are seeing Aus Act distribution -- new distribution. We are seeing a couple of key account activities that are moving in the right direction, but not in this quarter. And this basically means it's delayed. But again, we are seeing the first signs of adding distribution and key account activities that are successful. So we are optimistic that we will eventually get there.

A little bit more slow growth down in the growth in China. You know that we came out double-digit normally, and we're now into single digits, not dramatic change, pretty much what we've seen before.

And then funny enough, you know that we had problems in Singapore with a dealer in Indonesia that initially, in the year, didn't buy what they're supposed to. They are actually getting there. They'll buy now, and it's fine. And then just to realize that our Marine business that's based in Singapore is being hit by a lower revenue. That is just something we need to see. How much is that depended on the macroeconomic environment? I don't know. We need to double click on that. So that's basically APAC.

And if we then look at the summary here, we've talked about the regions. Consumer is kind of stabilizing from a very, very bad Q2, and we -- that's as we expected it. Private label has, this year, been a bit up and down. Earlier in the year, we had a number of our Private label customers who said, "We would like to make sure we have all of the products we need in due time for season '20, so we would like you to deliver in Q4." Now given what is happening in the market, they're also becoming cautious and saying, "Hmmm, let's be careful with that and see how the whole European situation develops." So it's been a bit of a yoyo in that sense, but the same reason. We believe they want to pull in revenue. Now given the environment, they don't. And that's really what it is.

And with that, I leave it to Karina.

Karina Deacon ***Nilfisk Holding A/S - Executive VP, CFO & Member of Executive Management Board***

Thank you. If we look at the preliminary EBITDA margin, we expect to report 7.2% of Q3 '19 versus an operating performance of 10.5% in Q3 2018. We improved on the gross margin compared to the quarter in 2018. So this decline in the EBITDA margin is solely attributable to the overhead costs.

If we look at the gross margin, we are up by 60 basis points over the same quarter in 2018, and it is a mix of positive and negative effects. We continue to see an uplift from divestments and also the other simplification initiatives, which we've discussed at earlier calls. However, we have an offset from raw material prices and tariffs. We've talked about this throughout the year. As you might recall, after Q2, I said that the impact would be more profound because we had now a full quarter impact in Q3 and we will also, of course, have that in Q4. So there is a slight deterioration compared to Q2 on that one. But then in addition, we have in our factories, a lower capacity utilization linked to the fact that they are now reducing their production to reflect the lower revenue and the lower demand that we forecast.

If we look at the overhead, as we talked about in August, we have initiated some cost-saving initiatives based on what we saw in late June and also into the third quarter, and we see the impact of that inner overhead cost being DKK 4 million lower than the second quarter of this year. However, due to the lower revenue we see, if we measure overhead excluding depreciation in the percentage of revenue, we've seen an increase to 34.3% of revenue, up from the 30.4% we saw in 2018 for the third quarter. So all in all, that gives us 3.9 percentage points worse on the overhead.

If we turn to Slide 9. Then with the basis in what we have seen in Q3, we have found it appropriate to adjust our full year guidance. We, of course, take into account what we have seen in Q3 and also what we expect to see in Q4. And if we look at our adjustment of the organic growth in the branded professional business, there are a number of reasons for that. As Hans Henrik talked about, we look into situation where we've seen a further slowdown in the German market. And also as we've explained, we see now a spillover effect into the neighboring countries.

We've also seen, again, like Hans Henrik said, a continuous weakening of the Industrial segment across EMEA, mostly profound in the Southern part of EMEA, and we do see indications of this weakness spreading into other segments.

In the U.K., we see a more cautious approach from our customers. So when we look into Q4, we believe that we can look into a slowdown compared to Q3. And then in the U.S., as we explained, we had a down -- or a shortfall in our HPW business, not growing as expected. And in the remaining business in the U.S., we do see a slower result for our growth plans.

And finally, as we talked about in the APAC business, we had a disappointment in Q3 and we don't expect to pick up to the extent we felt and compensate for that in Q4. So that's why it's always a part of the adjustment of the guidance.

Outside the branded professional business, as Hans Henrik said, we see a more cautious approach from the Private label customers.

If we look at earnings, clearly, the lower growth expectation impacts EBITDA. We have and we are still looking to see what we can do in the cost level, but it is very short time we have now to cut further into our overhead costs. So we're not -- so we don't expect to be able to fully compensate for the lower growth. That goes our overheads, but it's also affecting our factories where, as I said, we have lower utilization of our capacity, which means that we also expect that our gross margin in Q4 would be lower than what we had expected initially.

So all in all, that leads us to an adjusted full year guidance as shown on Slide 10 where we take our guidance on branded professional down from flat organic growth to approximately minus 3%. Our consumer business will remain under minus 10% to minus 15%. So we have not changed that. On Private label, we expect now a negative growth of between minus 10% to minus 15%, which means that our total business, we adjust from approximately minus 1% to now approximately minus 4.5%.

On the EBITDA margin before special items, we previously expected to be within a range of 11% to 11.5%, and we now adjust that to approximately 9.5%. If we add the IFRS impact to that, we will reach approximately 12.4%.

And with that, back talk to you, Hans Henrik.

Hans Henrik Lund ***Nilfisk Holding A/S - CEO & Member of Executive Management Board***

Thank you. So mid-term targets. To get to our mid-term targets, of course, we need growth. And with what we're seeing now especially in the European economy, we're obviously not seeing that growth. So right now, believing that we will get there in '21 is very unlikely. We've evaluated again and we believe in the potential, saying that we can get to an EBITDA margin of 13% to 15% and a growth of 3% to 5% for Nilfisk. However, we don't really know when the economical conditions will improve. Hence, we're unable to tell you right now what year we believe it will happen. And that's basically the message. We are reconfirming that we believe we have the potential, and we're saying '21 as we have out there now is unlikely to happen because of the economical environment, and we will come back and update you when we have more visibility on the economical environment. That's all we can comment on right now.

So with that, we are ready for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Kristian Johansen.

Kristian Tornøe Johansen ***Danske Bank Markets Equity Research - Senior Analyst***

A couple of questions from me. First of all, can you tell us how your financial gearing has developed in the third quarter and whether we should be concerned for any potential breach of covenants?

Karina Deacon ***Nilfisk Holding A/S - Executive VP, CFO & Member of Executive Management Board***

Nice question. We are releasing preliminary numbers now. So obviously, we're still working on the balance sheet. However, I can confirm that you don't have to worry about us breaching any covenants.

Kristian Tornøe Johansen ***Danske Bank Markets Equity Research - Senior Analyst***

Okay. Then just sticking on the subject. Looking at your Q2 report, you have grown EUR 405 million and your EUR 550 million credit facility. Considering your current challenges, do you feel that this facility gives you enough headroom going forward?

Karina Deacon ***Nilfisk Holding A/S - Executive VP, CFO & Member of Executive Management Board***

Yes, we have enough headroom.

Kristian Tornøe Johansen ***Danske Bank Markets Equity Research - Senior Analyst***

Okay. Then in terms of the cost savings, you mentioned that it's all -- I mean, it's essentially too late in the year to do much. Can you just elaborate on your considerations for next year because obviously that's a different case time-wise? So do you expect to initiate new initiatives to reduce our cost base looking into next year?

Karina Deacon ***Nilfisk Holding A/S - Executive VP, CFO & Member of Executive Management Board***

I think there are 2 ways of looking at it. If you look at our factories, of course, we are now looking to adjust the capacity to reflect the lower demand. So that's one part of the equation. If we look at the overhead, we initiated a cost-saving exercise over the summer and we knew that there was more to look into which might have a longer rolling time and was more of a structuring change. So those discussions continue. So obviously, we are looking to see what we can bring down further. However, I don't expect that it will have, if any, but fairly not a significant impact in Q4, but we certainly look into how to reduce the cost level going into 2020.

Hans Henrik Lund ***Nilfisk Holding A/S - CEO & Member of Executive Management Board***

And there are 2 elements to it, Kristian. There is the full year effect of what we've managed to pull off over the summer and then there are, of course, additional activities that we are looking at.

Kristian Tornøe Johansen ***Danske Bank Markets Equity Research - Senior Analyst***

Okay. That's quite clear. And then on the development in the EMEA, just curious whether you're seeing any different behavior on price as I assume that your competitors are also facing these fairly significant headwinds. And also from a customer perspective, are you seeing any customers trading down? Meaning with -- if they usually bought premiums products, have they traded down to mid-market or any movements like that?

Hans Henrik Lund ***Nilfisk Holding A/S - CEO & Member of Executive Management Board***

So I'll come back and answer directly, Kristian. But if we start from the top, it always hit industrial first. And the way it hits industrial is the pipeline is there, but it's never been concluded. It's been postponed, postponed, postponed. That's classically what we see in the industrial segment. So there is really not a price consideration.

Then if you go Germany, then clearly, we're seeing a slowdown of all of our high pressure washer business. That is more over-the-counter, and that's simply a sellout that's not happening. We're not seeing any of our dealers that are taking prices down really in that segment either. And then you can -- actually, the third element that we start seeing is contract cleaner tenders are becoming fewer in Germany compared to the year before, which classically means that they are using the machines longer, they're holding back. So in all of these cases, are we really seeing price debates nor are we seeing a significant level of freight down. I can't conclude that it's going to stay like that, but we haven't really seen it yet.

Kristian Tornøe Johansen ***Danske Bank Markets Equity Research - Senior Analyst***

Okay. Excellent. And then just my last question, if I may. So you sort of state that the strategy in the U.S. is the right one, but things are just progressing slower. So when should we expect to see the pickup in growth, which you had previously indicated it should come here in the second half of '19?

Hans Henrik Lund ***Nilfisk Holding A/S - CEO & Member of Executive Management Board***

I think we are in '20 with that one, Kristian, to be honest because we're, of course, careful with what we saw in Q3. I'm not going to sit here and promise you that I see a different result in Q4, that would be naive. So I think we are in '20.

And again, if I elaborate just a little bit on it, looking at this business in 3, looking at the commercial institutional side of it, if I look at my current top 25 dealers, they are growing year-to-date. So the underlying business there, you don't see it because we have some comparisons from last year that is not really apples-to-apples anymore as we've spoken about it before. So that part, I think the U.S. team, they have proven that they can get it right.

Now next step is to get the industrial side of it right. It's not different from what they've done in the CCI business, it's the same logic. We have a little bit of a different distribution picture because we have fewer distributors in industrial. So there are some white spots that we need to cover that are currently not covered, and that's taking a bit longer. And on the national accounts, we have shrunk the amount of accounts we go after because we want to go after the right ones. And there is a lead time on that, of course, breaking through, which is hard to predict, and we've been over optimistic on when we thought that would happen. So that's kind of the logic. If I operate it, I would say, 1 down, 2 to go.

Operator

Your next question comes from the line of Casper Blom.

Casper Blom ***ABG Sundal Collier Holding ASA, Research Division - Lead Analyst***

Casper from ABG. I understand you can obviously not sort of predict when growth rates will return. But can you give sort of any indicate on -- can you say how long would you need a growth of this 3% to 5% before you would be able to get up to your target EBITDA? I mean would it be enough to have 1 year with that? Or would you need sort of 2, 3 years in building up?

Hans Henrik Lund ***Nilfisk Holding A/S - CEO & Member of Executive Management Board***

I'll guide you a little bit, Casper, but how do I do that without saying things I don't want to say at this moment. So let me be cautious and say, our level of growth needed to get to the 13% to 15%, assuming that we can take out the costs we believe we are able to take out, is not that high, let me put it like that. But we need growth, obviously. I know that's a very, very vague answer. But at this moment, Casper, I just don't want to go any further, please.

Casper Blom ***ABG Sundal Collier Holding ASA, Research Division - Lead Analyst***

Fair enough. But I mean up until now, you did expect to reach in 2021.

Hans Henrik Lund ***Nilfisk Holding A/S - CEO & Member of Executive Management Board***

Correct.

Casper Blom ***ABG Sundal Collier Holding ASA, Research Division - Lead Analyst***

So that would suggest to me that if you had, let's say, 1 year or 1.5 year of, I would say, a more normalized growth, you think you could get there? Has that assumption changed?

Hans Henrik Lund ***Nilfisk Holding A/S - CEO & Member of Executive Management Board***

I think the visibility is so low, Casper, right now that I would rather not go there and speculate with you on this call. We need to get some more mileage under our belt in terms of this environment to be able to really give you good answers. That's where we are.

Casper Blom ***ABG Sundal Collier Holding ASA, Research Division - Lead Analyst***

Fair enough. Kristian touched a little bit on the balance sheet and cash flow as such. Karina, can you give any flavor on how this situation is impacting your working capital? I could imagine that you've built up some inventory that is now sort of tracking down -- working in the wrong direction?

Karina Deacon ***Nilfisk Holding A/S - Executive VP, CFO & Member of Executive Management Board***

The answer is yes, but the answer is also that we are, of course, looking at that, and we were immediately when we saw the decline in demand. So we are working intensely to get those inventories done.

Casper Blom ***ABG Sundal Collier Holding ASA, Research Division - Lead Analyst***

Can you give any guidance on, for example, did you know the working capital impact issue? And also, for example, would you expect to reach a positive free cash flow?

Karina Deacon ***Nilfisk Holding A/S - Executive VP, CFO & Member of Executive Management Board***

That's too early, Casper.

Casper Blom ***ABG Sundal Collier Holding ASA, Research Division - Lead Analyst***

Okay. Then just a housekeeping question. You have this 13% to 15% medium-term EBITDA margin target. Is it fair to just add the 290 basis points from IFRS 16 on top of that for sort of the years to come?

Karina Deacon ***Nilfisk Holding A/S - Executive VP, CFO & Member of Executive Management Board***

Yes. You should add the 270 because as we talked about before, it's a nominal number. So when we look about the percentage, it varies a little bit. But I think it's -- so the 290 we have right now is because we have this low revenue number.

Casper Blom ***ABG Sundal Collier Holding ASA, Research Division - Lead Analyst***

Okay. So it's 15.7 to 17.7, so to say?

Karina Deacon ***Nilfisk Holding A/S - Executive VP, CFO & Member of Executive Management Board***

It depends what the top line is at that stage, Casper.

Hans Henrik Lund ***Nilfisk Holding A/S - CEO & Member of Executive Management Board***

But today, you're right.

Operator

(Operator Instructions) Your next question comes from the line of Claus Almer.

Claus Almer Nielsen ***Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT***

Also a few questions from my side. The first question goes to the declining revenue. Listening to this call and also the announcement, it sounds like you believe the client only comes from a declining macro situation and not internal issues. Is that how we should look at it? That would be the first question.

Hans Henrik Lund ***Nilfisk Holding A/S - CEO & Member of Executive Management Board***

Then we need to be more granular. I would say, for EMEA, Claus, yes. And why do I say that for EMEA? I say that because on the public numbers, we can conclude that we've taken share for probably the last 4 quarters. I don't know how it's going to go in Q3, obviously. So we have no reason to believe in any of the previous quarters that we've lost market share against the numbers we know and against what we know from cash officially. So that's the starting point.

The second point is, if any of the internal changes we had done would have caused any of this, I know a number of people in the market that would have been the first ones to call us and use it proactively. And I've just been with all of the GMs, and I'm not hearing anything about it. So we're quite convinced in Europe that it is the macro economical development that is hurting us.

If you go to APAC and you go to U.S., in reality, that's more internal doings. We've just not been good enough in fixing Australia fast enough, clear point. And then as you heard, we've had some high pressure washer doings in U.S., plus implementation of our growth plan in industrial and in national accounts is slower than we had anticipated. So for Europe, I would conclude, yes, not for the other regions.

Claus Almer Nielsen ***Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT***

So is the -- where are we going to see the numbers from China and also maybe some indication from peers, and let's just assume it is also internal issues in EMEA. Will you then change your strategy or you're so sure that you are doing all the right things?

Hans Henrik Lund ***Nilfisk Holding A/S - CEO & Member of Executive Management Board***

We are. We're not going to change strategy in EMEA. We've been winning market share in EMEA for the longest time, and we have adjusted our strategy. We haven't fundamentally changed it. I don't see, Claus, that, that would lead to change. Now Claus is barking at me.

Claus Almer Nielsen ***Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT***

No, no, that's my dog. He didn't like the answer.

Hans Henrik Lund ***Nilfisk Holding A/S - CEO & Member of Executive Management Board***

Okay. Good. So Claus, there was no strategy change around the corner in EMEA. And again, Claus, also have in mind, of course, that we grew 8% in EMEA last year. So of course, we knew it by heart, so we're up against tough comps this quarter.

Claus Almer Nielsen ***Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT***

But then looking at your interest in Q4 of any revenue growth guidance, that's around minus 6%, I think, despite a somewhat easier comparison that we saw in Q3. So that's definitely negative trend. Is that what you're seeing in the first 1.5 months so far? Or should we think as a conservative view for Q4?

Hans Henrik Lund ***Nilfisk Holding A/S - CEO & Member of Executive Management Board***

You know I can't comment on that as such, but I can say that personally I don't enjoy these calls where we're not meeting expectations. There's a limit to how many of those we want to have, and I think we've crossed that. So of course, we are cautious on the rest of the year.

Claus Almer Nielsen ***Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT***

Right. Okay. And then coming back to the covenants question. Can you give some flavor to what covenants do you have?

Karina Deacon ***Nilfisk Holding A/S - Executive VP, CFO & Member of Executive Management Board***

We had 1 covenant, which is linked to the relationship between EBITDA and net interest-bearing debt. That's the only covenant we have. But I can confirm that we have no issue with that.

Claus Almer Nielsen ***Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT***

Okay. But you're not going to give any level on that covenant?

Karina Deacon ***Nilfisk Holding A/S - Executive VP, CFO & Member of Executive Management Board***

No.

Claus Almer Nielsen ***Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT***

Okay. And it's on the whole debt or it's only part of the debt?

Karina Deacon ***Nilfisk Holding A/S - Executive VP, CFO & Member of Executive Management Board***

It's on the whole debt.

Operator

There are no further questions at this time. Please continue.

Hans Henrik Lund ***Nilfisk Holding A/S - CEO & Member of Executive Management Board***

So no further questions, then I want to thank you for showing up with a short notice here and doing it even in a week where we don't want normally on vacation. So thank you for joining. Have a good day.

Operator

This does conclude our conference for today. Thank you all for participating. You may all disconnect.