THOMSON REUTERS

EDITED TRANSCRIPT

Q3 2019 Nilfisk Holding A/S Earnings Call

EVENT DATE/TIME: NOVEMBER 14, 2019 / 9:00AM GMT

CORPORATE PARTICIPANTS

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

CONFERENCE CALL PARTICIPANTS

Claus Almer Nielsen *Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT*
Kristian Tornøe Johansen *Danske Bank Markets Equity Research - Senior Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Nilfisk Q3 Interim Report 2019 Conference Call. (Operator Instructions) I must advise you that this conference is being recorded today, Thursday, the 14th of November 2019.

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

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

Thank you, operator. Thank you all for joining us for the Q3 announcement call. And I'm here with Karina as always. And I would like to kick you off with the highlights, what are we looking at. And as you know already, we had a very tough quarter in Q3, mostly impacted by the financial conditions in EMEA, which hurt us significantly and drove us down with a minus 7.0% in Europe, driven out of a Central region, driven out of Germany. We also had a difficult situation in APAC with minus 5.4%. And then finally, Americas with minus 1.1%, mainly driven out of the high-pressure washer business. All in all, that led us to a situation where the organic growth in our core business, the professional branded was minus 4.7%. Consumer and Private label were also in a difficult spot during the quarter. Hence, all in all, we have to report a negative 6.8% for the total business for the quarter.

Gross margin compared to similar quarter last year did improve by 0.6 percentage points to 41.5%. And you know, this is all of the simplification initiatives that are helping us. However, they were offset by, clearly, the tariffs imposed on us and then lower capacity utilization in the factories, given the slowdown in the market. All in all, it led us to report a 7.2% EBITDA before special items, which is down by 3 percentage points compared to similar quarter last year, obviously mostly driven by the increased overhead ratio.

Those were the hard facts from a difficult quarter. Then, if we talk about the strategy Nilfisk Next, we are fully committed to the strategy. We continue every single day implementing the strategy. A very important part of that is to build a global organization, where the local sales companies are focusing on sales, supported by service, marketing, finance and so on and so forth, from streamlined global functions. And that implementation continues, and it also did in Q3.

We're supported by systems. We are now done with sales force in all our major markets. So we have the right systems in place, and we've established a global service function. We've also have global operations now take over local logistics and warehousing, so that we have all related activities under one hat and not as part of the sales companies.

R&D-wise, we have had autonomous and digital as sort of incubators. Through this quarter, we decided to integrate it into the normal Nilfisk organization. We found that it is part of our normal business, and we want it closer to the classical functions. And we also found, of course, that some of the cost could be reduced due to overlapping overhead structures before. So a fairly big move during the quarter.

The other thing we did was we looked at our IT project portfolio. And admittedly, we found some, where we just say, look, this is not now, we have to reprioritize and do it later, which is also, of course, addressing the current market situation.

We found another synergy potential by integrating the back end of the Consumer business. i.e., manufacturing, R&D. That is now part of the central business as well. And then, of course, given where we were in the quarter, we have applied general prudency across all functions. So you can sum it up, the actions we took and we spoke about it last time, they were sort of threefold. We looked at our investments, and we've proved the investments and taken them a bit down that we will see moving on forward, both within our IT and

R&D, and we do that with confidence. We feel these were the right moves to make. We have accelerated some of our blueprint activities to change further cost reductions that way. And then finally, we've just been prudent on the overall business. So those are the reactions we've had to it.

In the front end, of course, we keep selling hard every day. We've visited more end users than we did before. We do a little bit of extra campaigning and so on and so forth and find the pockets of growth that we can given the current environment. Overall message, strategy unchanged, and we do some tactical moves to address what's going on in the market right now.

That brings me to a bit deeper conversations about it. We spoke about EMEA and we spoke about Central region, Germany already. Through the quarter, we saw it get worse. We also saw spread outside Germany to the related countries to form Eastern European countries, of course, Austria, Switzerland and it's mostly the countries that are related to German industry that's hit. So that's really what it was.

We also saw the industrial segment spread a bit to south and hurt us there. However, important to remember that last year, we had a stellar Q3 in south. So it looks a bit worse than it really is. You all remember, it was the last quarter of Jean-Philippe last year. So there's a year-over-year consideration to have as well.

Nordic. An interesting development because we've really started growing in Denmark again, which is hard from a high market share perspective, but we have now consistently shown that. You're not seeing it really in the numbers because we had a huge order in Finland last year that's masking it. Very important to know that Denmark is back to growth.

U.K. We are -- we're quite happy with it, given the environment that existed during Q3. We're still on the positive. However, we are seeing more cautious customers. Gross margin down mostly because we have lower capacity utilization due to the slowdown. That's the main thing. There is a little bit of mix as well on the fact that our industrial products are high-margin products, and the industry has hit the most. So that's really what it was in EMEA.

Americas. Well, a few curveballs on the high-pressure washer business, 2 things: we had one of our large dealers go bankrupt, and obviously that hit us; the other thing was the agricultural segment in Americas, we're not that strong. So those 2 were really influencing us.

And the biggest new things in our U.S. Floorcare, we continue executing our growth plan. We have to say that it takes a bit longer in some areas to execute it. We have no doubt that what we're doing there is right, but it takes a bit more time. After 3 quarters of growth, we were sort of getting used to that. Okay, we were getting that. But we just have to say that we're not consistently delivering yet, and it will take a bit of more time.

Gross margin, of course, again hit by the capacity utilization, and then on top of that, tariffs, really the big swing.

APAC. The same, same story we've talked about.

Australia. We have issues getting it fixed. It keeps declining. Two elements of it, if I go a little deeper. The Nilfisk business out there is actually getting okay stabilized. We have some wins that are coming in, and it seems like it's getting better. However, the business we acquired some years back, (inaudible) is really what's driving it down at the moment, and we need to find a way to stabilize that.

Then maybe the only news here, Malaysia was hit by government spends in the quarter. New government came to a new conclusion and basically lower spend, and that has hit the business.

Overall China, which is the most important market for us out there, we are still growing, however, at a lower pace. So we're in the single digit now than we've been before where we were at double digit. Trade wars is really what we see. It is impacting out there as well. So more or less, we have known issues in APAC that we need to work through. Again, capacity down and then a lower share of revenue from Pacific. That's what it is.

Consumer. We said that what we saw in Q2 with a huge drop in the 20s, would stabilize in Q3, and it did with a minus 9%. So funny enough with the minus 9%. It was as expected and not much preferable to comment on that business.

Private Label. That's been the yo-yo this year, where our customers basically said in the beginning of the year, and we want to be well prepared for the season. We want to take some more stuff in Q3, Q4 to be in the right place. However, that changed during the quarter, and I can only assume it's because of the macroeconomic environment. So obviously, a disappointment that it didn't go as we predicted.

Those were the business areas. And then, Karina, pleasure to leave it to you.

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

Yes. Let's look at the revenue development first on Slide 9. Overall, it declined by about 10% in Q3. And obviously, as we've talked about, it was significantly impacted by the negative organic growth. We also saw the continued negative impact from the 5 divestments we did in '18, and the impact here in Q3 was EUR 13.5 million, equivalent to a decline of 5.3%. On the other hand, we got better tailwind from changes in FX, most significantly the U.S. dollar, and that meant an increase of 1.8%.

The organic growth negative by 6.8%, minus 4.7% in the branded business. As you can see in nominal terms, most severely hit by EMEA, but also a big negative contribution in APAC and clearly, from Consumer and Private label, as we already talked about.

If we turn to look at EBITDA, we saw significant negative impact from the lack of revenue, which brought EBITDA down from EUR 26.8 million in Q3 last year to EUR 16 million in Q3 of this year before the impact of IFRS 16. We did see an improvement from the gross profit was up EUR 1.4 million, and we had a slight increase in overheads. So when we look at the EBITDA margin, it's clear that the impact came from the overhead measured in terms of percentage of revenue, where the ratio went up. And that meant that like-for-like, we saw the EBITDA margin before special items being reduced from 10.5% to 7.2% in Q3 of this year.

If we look at the gross margin and the development, we saw it improved from 40.9% to 41.5% in Q3. After the first half year, I said to you that I saw a normalized level of about 43.5%, but I also warned to you that we will see that go down in the second half. Like in previous quarters, we saw the continued positive impact from the simplification initiatives, procurement, pricing, the ones we've seen throughout the year. But as expected, it was partly offset by particularly the tariffs where we in Q3 had the full quarterly effect of the May increase, where a number of items were lifted from 10% to 25% tariff. In addition to that, we saw, as we expected, a significant negative impact from the capacity utilization in our factories due to the lower input -- or output, sorry, in Q3 this year compared to last year.

Looking at overhead, we've made and shown a bridge like we have done in the last couple of quarters, relatively detailed. Let me just put a few words there. We continue to follow the plan for our cost-saving program, and we saw positive impact in the quarter of about EUR 1 million. As I have explained before, the overhead impact is not going to be significant in the rest of the program. It is very much in the gross profit we will see the remaining initiatives. We have now executed EUR 39 million of the total EUR 50 million, which were expected in the program. And we follow the plans and we expect to execute the remaining initiatives in Q4 and also going into 2020. And I'm confident that the EUR 50 million we set out to find they will be found.

In addition to our cost-savings program, we also saw some savings derived in part from our blueprint work and efforts as well as other savings going back to what Hans said about being more prudent in general.

We continued our investments in the future, and we spent in the third quarter about EUR 2.7 million in this area, and it was covering the same things we've talked about before, continued efforts in our digitization, increased marketing efforts, such as closing on customer insights, customer experience, et cetera. And then we saw in Q3 a higher amortization when we look at the same quarter last year and that reflects the increased level of investments that we have done in previous quarters in both R&D and also IT.

Looking at another issue in the overhead, which is related to the R&D, as we have explained, we implemented a new structure to improve efficiency. That meant that in the quarter, we actually reduced the total spend, but the nature of the activities meant that we expensed more in Q3 compared to Q3 of last year, even though, as I said, the total spend was reduced.

Finally, unfortunately, some one-off costs impacting overheads in the third quarter, a bad debt provision, in particular, but also some consultancy costs that we didn't had at the same level in the same quarter of '18.

Looking at balance sheet and cash flow. And in nominal terms, we saw adjustments in our working capital compared to last year. But with the lower revenue we've seen if we measure on an LTM basis, we did see the working capital percentage increase. And compared to the second quarter, we saw a marginal increase.

As I've explained before, we continue to focus on reducing working capital, but we have this in our LTM numbers with the benefit from payables being reduced compared to last year. So we need to compensate for that with improvement in inventories and AR, and we do continue to focus on that. And with the new global responsibility for inventories across the group, there are a better basis for improving the inventory levels going forward.

On accounts receivable, we focused continuously on that, and we have made improvements in our collections and also driven down our overdues and -- but there is still work to be done around our processes and systems to bring it further down. But in the quarter, we did see also from a cash perspective a positive impact from working capital, which we were very pleased to see.

If we look at the CapEx level, as we talked about after Q2, we would be a little bit more prudent, and we have lowered our investments compared to the third quarter of '18, with total CapEx in percentage of revenue going down from 5.1% to 4.7% and also in nominal terms, reducing it by more than EUR 2 million.

All in all, we saw reduction in our net interest-bearing debt of EUR 9 million after the effects from IFRS. So the net interest-bearing debt after Q3 was EUR 372 million, if we take away the IFRS impact. And this number is, of course, the number that we need to compare with when we look at our committed facilities of EUR 450 million.

So as I said, also, in October, we don't have an issue in terms of our facilities. We renegotiated them during the quarter. As you know, they were maturing in 2020, but we had from our side options of expanding or extending their facilities, and we have done that. So they now mature in July 2020 -- '22, sorry. Thank you.

That was what I wanted to say about the financials, and that brings me to outlook and not much news in that compared to what we talked about on the 16th of October. We have reiterated our expectations for the full year. So just to state the numbers, approximately minus 3% organic growth in our professional business, minus 10% to minus 15% in both our Consumer business and our Private Label business, which means that we will expect approximately minus 4.5% organic growth in the total business. And looking at the EBITDA margin before special items, we expect approximately 9.5% before the impact of IFRS and including the impact of IFRS approximately 12.4%.

So that concludes our presentation. So now we are ready for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We have one question come through so far. It's from the line of Claus Almer from Nordea.

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

A few questions here. First of all, you're going to exit the Consumer business in APAC, which I think will have an EUR 8 million revenue impact. Is this reflected in your organic revenue growth guidance? Or how will this impact that guidance?

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

Yes. That is reflected in the guidance. You're absolutely right. But as you say, you've got to be aware, when you take the organic growth going forward, that you need to take some divestment impact out. And we've also given you the number, which is -- let me just quickly have a look here because sorry, I can't remember that. It is about EUR 8 million that you have to compensate for when you make the organic growth going forward.

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

So Q1, 2 and 3 is based on still APAC Consumer business, and then Q4 will be adjusted for this. Is that correctly understood?

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

That's correct.

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

So when you try to calculate the interested Q4 organic revenue growth guidance, if you not take this into account, then you will be minus 8% or in that range. What will it be, if you adjust for this?

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

It will lead to our guidance of between minus 10% to minus 15%.

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

Yes. But I mean, on group level, the interested organic revenue growth for Q4, what should we expect for Q4, actually, with this impact?

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

I don't have the exact number for that.

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

Okay. Maybe I can get back to that at a later point.

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

Yes. We can go back and calculate that exclusively. It is included in the guidance.

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

Yes. But it's very difficult to calculate as we don't -- we're now trying to mix 9 months in the Q4, which is based on different starting point so to speak. Then...

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

We'll give it later on.

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

Perfect. Then coming back to your full year guidance and also your explanations for the profit warning that it was -- it is mainly caused by the whole macro situation. But now we have numbers for tenants and both Q3 but also implicit Q4, it seems Nilfisk is way more hard hit than they are, they're actually still in the positive territory. So there might be more than just macro, have you more in-depth thinking about what's the difference between you and tenant?

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

I think, Claus, on that one, we start with the European situation. They have reported 3 quarters of negative numbers as well. They also confirm the difficulty here. So we're seeing eye to eye on the market development in Europe. Q3, also from their side, confirmed a difficult market in China and APAC. So I think we are pretty good on those 2. And then the real difference is that they are doing a fantastic job in Americas, and we need more time to get there. That's really what it is when you compare the 2 companies.

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

Well. The EMEA performance is not in the same magnitude of U.S. decline, I would say, and you're taking out both Consumer and Private Label, which I guess is also...

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

Yes. They were about minus 2.4% for the quarter. We were minus 7%. You should look at the comparison numbers, we were 8.3% of the year before. They were down minus 4.5%. So of course, you have to look at how you compare to the past as well.

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

Sure. But so you're still thinking it's just a market demand issue, and it has no reason to adjust on your strategy in EMEA. Is that how should...

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

That is fully correct, Claus. There is no need to adjust the strategy in EMEA. We're comfortable with it. We do tactical things, Claus. We try to tilt our efforts towards the more promising segments. We do more end-user visits. We do a bit more campaigning. So that's all tactical moves. We've never really had a strategy problem in EMEA as such. We've had the challenge of leveraging the business better. You've been asking for that for a while. And we saw that in the early part of the year that we started making more money in EMEA. So the things we're doing in EMEA, we are very comfortable with. The challenge we have is, after many years of not growing in U.S., how do we get that right. And that was the biggest disappointment to me personally in Q3 that after 3 quarters of at least growth in that region, we were now in the negative territory. And of course, that is the cause of concern. What do we do? And we've reviewed it. We are comfortable with the strategy, the execution is a bit slower than we had thought, and we're addressing that. So it is really the difference in geography between the 2 companies that you see.

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

Okay. And then just my last question. With your new debt facilities, is that based on the same structure or anything there we should be aware of?

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

Yes and no, the structure is now instead of 3 banks, we now have 2. But it's based on the same kind of covenants, meaning 1 covenant linked to debts compared to EBITDA. So from that perspective, it's the same.

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

And you're paying the same interest rate?

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

Yes, we don't have any changes in that.

Operator

(Operator Instructions) Our next question comes from the line of Kristian Johansen from Danske Bank.

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

Just a follow-up on the new deal on the credit facility. So say still based on the same metric, but is the covenants also at the same level as in the old agreement?

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

Yes. We have one like we had before.

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

Okay. And what's the reason for one bank stepping out of your credit deal?

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

Well, it was simply in our negotiations with them. We looked at what's good for us, what's good for the banks. And then we agreed that having 2 banks would make more sense for us at this point in time. So no issue on that really. We continue to work with HSBC in our daily operations in the world. But on these facilities, we decided that 2 banks would suite better at this point in time.

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

Okay. Then my last question is, if we look at your organic growth guidance for the branded professional business, it obviously indicates a substantial worsening here in Q4 on the organic growth compared to when we spoke roughly 1 month ago. I assume you now have decent visibility on the performance in October. So has that confirmed the substantial worsening that you are guiding?

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

Let's not comment on it, Kristian. You have to ask, and I have to say, we don't comment on Q4, of course. So we really can't comment on that question.

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

Well, let me ask in a different way. What drivers is it you expect to substantially worse organic growth in Q4 versus Q3?

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

So we are -- we were basically -- and we're repeating what we said at the time, we were basically afraid of the Central region, that problem spreading to rest of Europe, both -- mostly towards south. And of course, there was a U.K. Brexit discussion as well. Those were the 2 major drivers of us being cautious. If I should add a third one, Kristian, then I would say, with what I saw in Americas, in Q3, which was a surprise to me, then, of course, we also turned a bit more cautious on, okay, what can we actually execute.

Operator

There are no further questions at this time, please continue.

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

All right. Thank you for joining us again, and I want to just say thank you to Karina as well. This was her last one. Karina, thank you for everything you've done on these calls. And thank you for joining all of you, and have a good day. Thanks. Bye.

Operator

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