Investor call

Wednesday, 17th October 2019

The Reasons for Changes in our Guidance

Hans Henrik Lund

CEO, Nilfisk

Introduction

Thank you, operator. Good morning everyone. Thank you for joining our call. I'm here with Karina Deacon as always. Today, we would like to walk you through what has happened with our guidance and the reasons behind it in a fair amount of detail. Before we get into that, we would like to give you insight on revenue and earnings for Q3, so you have as much information as we can give you at this point. Then on the headline number two, we would like to talk about what are the initiatives that has caused us to downgrade the organic growth guidance. It consists of, obviously, Americas, where we haven't grown as much as we expected, and then our simplification initiatives is the other major part of that.

Karina will come back and give you specific numbers on the different elements and how they impact guidance and overall financials related to our divestments. And then we reiterate the new outlook for 2018 and ending with Q&A.

Q3 Results

So if you allow me, before we go into the reasoning and just talk about how did Q3 actually go. We had a group organic growth of 2.6%, it brought us to 3.3% year to date. The highlight for this quarter three was the fact we actually grew 4.5% in the professional business, excluding private label. That was driven by a very strong performance in Europe with more than 8% organic growth. We haven't seen that for a while and it's a continuation of what we saw in Q2. It is Germany and France both being double-digit growth and we know that the European market is going well when these two were performing. So the strongest quarter this year on the core business, really, excluding private label.

We had zero in US, and I will come back and talk about that at length, obviously. And then we had a little bit of underperformance in APAC with about 2% growth in the quarter. However, given the changes that [inaudible] is implementing out there, it's okay. Because the real problem we have is US and the real stronghold in Q3 was clearly EMEA.

Speciality professional delivering 5.7% growth, acceptable as expected. And then consumer was -1.4; that was below what we expected. And then obviously we have, in line with expectations, a 15.5% negative organic growth on private label. No surprise there. We've talked about it, that both Q3 and Q4 last year was abnormally high on private label because we had a last-buy commitment towards our biggest private label customer. So part of that was planned, part of it was caused by supply issues but we will cover that in a second. We delivered an operating performance of 10.5 versus 8.9 last year, so a good solid improvement on bottom line.

All in all, the slow recovery in the Americas and, as I said, the execution of our simplification initiatives, divestments, closing a factory in China has caused us to guide the organic growth down to 2%, and also state that we believe that the 2018 earnings will be in the lower end of the 11.5 to 12.

The Reasoning: The Americas

Let’s go into the reasoning, starting with the Americas, which is obviously the problem that we have that we haven’t grown in Americas this year on the back of strong 2017, we haven’t been able to sustain it. You know, and we’ve talked about it consistently, that we lost a dealer that went private label. You know that we had quality and delivery issues for quite a while in US and you know that we restructured our internal salesforce and that was driving some of these things. That’s what really hurt us through the entire year.

I’m happy to report that after all in the end of Q3 in September, we had the highest output of our factory in the US that we’ve had for 18 months in terms of units and the outlook is strong for October as well. So now we can say that we’re really delivering the amount of units that we should out of the factory.

Market place

In the market place in Q3, we had a delay of two strategic account deals that we had hoped would come in Q3. They are still valid, they just did not happen in Q3, unfortunately. We had expected them to do it. The other part in Q3 was we were to some degree hit by a few orders that were cancelled because we couldn’t deliver to the times that people expected. We had a little bit of that discussion from Q2 as well and it continued into Q3.

Service Map

And then finally, we implemented Service Map as our IT tool in US in Q3 and that meant there were a lower service activity because quite frankly, we spent people’s time on training and other things, so we invoiced less service. So that’s really what happened. We communicated after Q2 that we could not promise quarter-over-quarter improvement; i.e. we did not promise we would grow in Q3 in Americas. However, we had hoped we would and we had planned we would. That didn’t materialise because of the things we just talked about and then we’ve actually – what we’ve said after Q2 that we will have a better second half in the US than a first half, which essentially means we believe in positive growth and we will deliver positive growth in Q4. But not a good year in US and Americas, obviously.

Simplification Agenda

Then, if I continue, then we go to the simplification agenda. You know that we’ve been having strategic reviews on outdoor. We are happy to now have it concluded and you know the reasons this was a part of our business where we were soft scale and we had no synergies with the rest of the business, really. And it is a market that is highly price competitive, tender based and it is a market where you have to do significant investments to come up with new engines and so on and so forth. Not a market that we were well suited for; hence we have been trying to sell the business over quite a while – for quite a while. And we succeeded within the last 24 hours and signed a deal where the Danish part of the business will be sold off, effective 1st January. We’re very happy with that. We’re happy for the employees, as well. And then our Italian part of the business we will intend to close down, starting immediately. So with that, we have exited the outdoor business.

We also have HydraMaster, our US restoration business, in strategic review; happy to report that that has also been sold. Again, a market where – it’s a small market, it’s a very niche market, not really our focus, so very happy to be able to sell that as well.

And finally, we sold a small HPW business in Turkey called Rottest €with a small revenue of €1 million. All of this is, of course, important because we want to be a more focused and simplified company and these activities, they have all in all been driving negative earnings. So for us to have it sold is a positive development for the future.

Manufacturing and Production

Then the other thing that we've talked a lot about is manufacturing and production footprint. We talked about earlier that we have 17 production sides and obviously we want to consolidate that. We closed the factory in China in Suzhou and outsourced part of the production and integrated the rest of the production into our Dongguan facility. So we now only have one facility in China. Exactly the right thing to do, and then building on that scale.

What happened there was we were planning to do the closure in Q4. All plans were there. Unfortunately in August, rumours started flying in the facility and we experienced heavy strikes, which was not something we could really control, at the end of the day, and then had to make a decision. We chose to close down the factory right away, knowing that was not our intention, our plan. So that meant we were not fully ready at the Dongguan facility, nor were we ready at the sub-supplier. So we've had to accelerate those plans and obviously we've lost manufacturing output through the period. And only now do we have a full overview of what we actually can produce at the sub-supplier and at our Dongguan facility. So unfortunate that it happened. However, closing these things and getting it consolidated is really important. We had all hoped we could do it without influencing output and revenue. It didn't go that way.

So that means we've had negative impact on consumer partly in Q3. That will continue into Q4 a bit. And we will also see a lack of delivery to private label customers because we just couldn't get the other production sites up quick enough given the accelerated closure.

Overall, if you look at it through this year, we've now closed six manufacturing sites, so that means we've taken a significant step into simplification, taking it from 17 to 11 sites. So that's a really good step and again, unfortunately, the China one did influence our ability to deliver.

So those are the reasons for the unfortunate change of guidance that we've done. And now Karina will walk you through the numbers part of it so you get a sense for what part caused what effect. So Karina, over to you.

Effects of Guidance Changes on the Financials

Karina Deacon

CFO, Nilfisk

Thank you. Let's just talk a little bit about Q4. When we look at the professional business where we said we have 4.5% of any growth in Q3, this is actually also what we foresee that we will have in Q4 around the same levels. And that includes that we will revert to positive organic growth in Americas, like Hans Henrik said. All in all, we will have negative impact from the private labels revenue of – estimated around €15 million because as we talked about, we had an extremely high Q4 last year, so all in all that will mean that we will have a negative organic growth in Q4. And that will take us down from the 3.3% year to date down to the expected approximately 2% for the year.

If we then look at how did we get from our previous guidance of 3-4% and down to approximately 2%, if we look at the impact from the Americas recovery, we estimate that in a range of up to 0.5 percentage point. And that means that if we had only had that incident and not done the simplification initiatives, we would have basically still been within our guided range. But because we took the initiative that we did, we see an estimated impact of those initiatives around one percentage point, which means that we will arrive at the approximated 2%.

Simplification Impact

If we look at why simplification has this impact, we can split it up in three initiatives. If we look at the divestments, there are basically two things that impact. First of all, we did have a very high organic growth in those two businesses. You might recall that after H1, our professional business grew 16% and speciality professionals grew 16.5%, of which HydraMaster and outdoor was a big impact on that. So when we now take them out of the equation, that means that we will see an average growth going down.

But maybe more importantly, we have anticipated from the beginning of this year that we will launch a new product in our outdoor business. Clearly with the decision to close down the Italian base part[?], that launch will no longer take place and that's why we will not have that revenue that we anticipated from that product launch.

Finally, and a smaller thing which is difficult to put a number two, is that the distraction of the not for sale period of time has of course also had and will presumably have an impact on the sales for the last quarter of the year.

Suzhou

If we then go to the Suzhou production, as Hans Henrik said, we needed to change and rule out production and we were not able to rank up to the extent that we had in the Suzhou production. We saw already in Q3 some impact on the consumer revenue but going into Q4, we will see that the impact, both on consumer but also on our private label business. If I am then to say which one of these has the largest impact, it is actually very much evenly distributed between the three factors. So roughly one-third of this percentage point allocated to each of them.

Bottom Line

Going to the bottom line, what happens there, well, we stay within our range but we do say that we expect it to be in the lower end. We've talked about before that we are not so sensitive to the top line but obviously going down to about 2%, it does have an impact. However, the majority of the downgrade on the top line relates to businesses where the earnings are below our average, so that means that we get a little bit of help from that. At the same time, we have of course also looked at our spend for the rest of the year and done our utmost to be careful on that. So that means that we believe that we can end within the range, however in the lower end.

Financial Impact

If we then turn to look at slide 8 at the financial impact of the simplification actions, let's look at the divestment of outdoor and HydraMaster. All in all, when we look at the transaction and we look over a period of time, we do expect to see a slightly positive impact on our cash flow based on these divestments and closedown. However, when we look at the P&L, we will have a charge of expectedly between €30 million and €35 million, not all of it incurred in 2018 but a lot of it. The majority of these, of course, comes from the outdoor business. We had a number of non-cash balance sheet items which we had to write off with no cash impact – things like R&D and also to a certain extent, some inventory. And then we also have some redundancy payments primarily related to our Italian business as we said we will have to close that down.

2019

So what does that mean for us going into 2019? Divesting a loss-making business and a business which is more or less breakeven will mathematically have a positive impact going into 2019. On some of these divestments, we have to consider the sticky cost and how to get them out of the business. I've talked about that before, that it is something that we will have to work with over a period of time. Also, we will have a little bit of activity in our Italian business in Q1 where we won't have revenue but we will have some costs because we simply can't close down the site before that. But the estimated impact overall is somewhere between 0.2 and 0.3 percentage points compared to an as-is situation.

The last thing I'll mention is the impact from the production footprint, there's no further news on that because we have already communicated the impact from our cost savings programme where we, after Q2, said that we expected relatively high restructuring costs the rest of the year. And that was to a very large extent related to the structural moves that we have now done. So no further guidance on that.

Summary

That means if we turn to the summary page on page 9, just reiterating that we expect approximately 2% organic growth for 2018 and an EBITDA in the lower range of 11.5-12.0%. And now we open up for Q&A.

Q&A

Operator: Thank you. Ladies and gentlemen, if you would like to ask a question, please press *1 on your telephone. We will pause for just a moment to allow everyone to signal. Thank you. And we have our first question from Klaus Kiel[?] from [inaudible] Credit Market.

Klaus Kiel ([inaudible] Credit Market: Yes, hello, Klaus Kiel from [inaudible] Credit Market. A couple of questions. First of all, could you help us a little bit from – coming from the adjusted EBITDA margin to the reported EBITDA margin here in 2018 because now there is quite a few moving parts. And while I'm thinking about that, below the adjusted EBITDA margin, you will be affected by approximately €18 million from the cost saving programmes, another will be another one-off in the range of €25 million from these one-offs you have announced today. And then finally, there also ought to be some kind of an impact from the phantom shares. But anyway, yeah, just some colour on how to get from the adjusted EBITDA margin to the reported EBITDA margin, that would be helpful. Thank you.

Karina Deacon: Yes. Thanks Klaus. I can answer that question. Going from what we call the operational EBITDA to the reported EBITDA, that is purely the phantom effect. We have after Q2 an accumulated effect of around €3.2 million in income. In Q3, we will have another charge to that, so we will end that in the next – after the nine months, a net income of around €2.5 million. So that will be the difference between the two, so you will see a higher reported EBITDA than our operational EBITDA margin.

If you then look – and you ask me about the special items, the guidance we gave in connection with our cost saving programme about restructuring, you will see the guidance there and when we announce the Q3 results in full, we will also update that number but use the Q2 reported number as a start. And then you could add these, around €25 million in special items, to what we have after Q3. That will be my best guidance on where to end.

Klaus Kiel: Okay. And these divestments, would they have any meaningful impact on your depreciations, yeah, both this year and going forward? Now I'm thinking again – now I'm thinking about the reported EBIT margin. So yeah, one step further down the P&L.

Karina Deacon: Yeah, for this year there's not going to be a lot of impact because we make the divestment 1st January for the outdoor business. Going into next year, we will have an impact but in terms of the current depreciation, it's not far off average. So you could just assume the average, €35 million, same as we have for group.

Klaus Kiel: Okay. Thank you very much.

Operator: Thank you. And we take our next question from Claus Almer with Nordea.

Claus Almer (Nordea Markets): Yeah, hi. Sorry if you answered this question before. I haven't listened to the full call. But nevertheless, could you please explain a bit on the read over to 2019 and also your mid-term targets. That will be my questions.

Karina Deacon: Yes, let me give you the first shot of that. Obviously, we haven't guided for 2019 and we will not do that yet but what I explained on the call is that we expect a positive impact, everything else being equal, of 0.2-0.3 in 2019 from these divestments. And that is because we will not be able to take all sticky costs out, plus the fact that we will have some activities in our Italian business where's there'll be no revenue in the first quarter next year. So assume somewhere between 0.2 and 0.3 uplift compared to as-is.

Claus Almer: Yes, Karina, that I saw but I was more thinking about the issues on your top line. Do you think everything has been solved by 1st January or will you still be struggling to regain the lost share wallet? That's actually what I'm trying to figure out.

Hans Henrik Lund: Yeah. And Claus, you are asking – I think you are asking, obviously, a US question, right? So from a top-line perspective, if you allow me to start from the professional business overall, the fact that we've gotten EMEA up in gear, so to speak, we were able to deliver the highest growth in the professional business minus private label for the year. You have pointed out previously that we might only be growing 2% in the core; this quarter we grew 4.5%, solely driven by EMEA more or less. So that's that part and we've no reason to believe that that's going to go significantly down. We believe we found a good formula in EMEA. However, doing such a strong quarter, we can't do every quarter. But, we found a good formula in Germany and France.

Then if we go to US, US, we have to see the positive growth in Q4. We will. We believe we are driving the right activities with Jamie O'Neill on indirect building new dealers and new distribution. And then on the national accounts, again, we're investing further with Oscar leading it. That, I believe, as well, is going well. And then I'm optimistic now on the output from the factory.

So all in all, if I take these three things and say what is that going to do to us in 2019, it will drive a more positive development in US in 2019. And I say that, Claus, with everything else even, right? It's hard these days with world economy and all other kinds of things. But with the initiatives we have in place, I believe we are going into a growth period again in Q4 and 2019 for US. And for the [inaudible] you might be, I can tell you that I'm spending a week in US at the moment to make sure that we have the right plans.

Claus Almer: Okay. Sorry about asking the same question but in a slightly different way, I'm not asking about you giving a 2019 guidance but is your budget unchanged for 2019 based on what we have seen so far this year? Or what's your thinking about that?

Hans Henrik Lund: That's unchanged, Claus.

Claus Almer: Okay.

Hans Henrik Lund: There's no change to that. And I have heard you ask about the mid-term guidance and if we operationalise the mid-term guidance, for Karina and I, it has always been we must be above 13% in 2020. And that's an unchanged target; that's exactly what we're trying to do.

Claus Almer: So even though you are ending out in the low end of your 2018 margin guides this year, you are still confident about the mid-term target, right?

Hans Henrik Lund: Yes. Yes, Claus. And here's the deal. Let me just give you for the simplicity of it, right? Whether we end at 11.7 this year or we land at 11.5, it is approximately €2.5 million difference. So we believe that – that's how sensitive the business is and we believe there's no reason to change any mid-term guidance based on this year's performance.

Claus Almer: Okay. Thanks.

Operator: Thank you. Ladies and gentlemen, as a reminder, please press *1 to ask a question. Mr Lund, it seems we have no further questions at this time. And with this I would like to hand the call back over to you for any additional closing remarks.

Hans Henrik Lund: Thank you so much, operator, and thank you for listening to us. We are happy to provide as much detail as we can and I hope we accomplished that. And with that, have a good day. Thank you.

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