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Nilfisk A/S Interim Report Q3 2017

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+++ presentation

Hans Henrik Lund^ Thank you very much. Good morning, everyone, and thank you for joining our call, our first call as an independent listed company. I'm joined here by Karina as always, and we would very much like to go through our Q3 interim report with you.

We'll start up with some highlights, then go into the financial review and talk about the outlook, and then, of course, we are available for Q&A at the very end.

Let me just set the stage real quick by saying this was a quarter that went as expected as planned. We knew pretty much what would happen in the quarter in terms of private label and so on and so forth, so this has been planned all along.

We were happy with the organic growth ending at 3.4% for the quarter. You have also seen that we're now so fairly confident for the full year that we have narrowed the guidance from 2% to 4% and now 3% to 4%. So good -- happy with the growth.

EBITDA was down to 8.9% for the quarter, and as we've discussed before, it is mainly driven by private label. That was about 8% of our revenue for the quarter, which is more than it was first half where it was only 4%. So that's driving it down plus, of course, the material increases plus the freight. So that's what's behind it.

We are currently after the first nine months of the year at 11.7%, which you can compare to 11% at the same time in 2016, so we feel comfortable with that. RoCE is up as well as you see up to 16.5%.

If I talk a bit broader about the business, what happened in the quarter, I can update you and say that our a -- Liberty A50, there is no change to the plan. We will ship the first units end of this year or beginning of 2018. You've also seen through the quarter that we have intensified our actions when it comes to robotics by doing a partnership with Blue Ocean from Denmark. So those are sort of the deals of forward-looking at dividends.

If I give you a bit more insight on what we call sort of the core business, which is about 80% of the business, and I walk you through that by regions, EMEA came in really,

really strong with 10.6% growth. We all know that we were helped by private label along the topic. If I talk about what it would've been without private label, we're down to about 3.3%, 3.4% in EMEA, which is acceptable as well. You see a 5.9% growth in EMEA after nine months, which is strong as well in today's market.

U.S., as you remember, we had a very tough comparison quarter with 11% the year before, so we ended up flat or -0.1%. However, we still see good momentum in Americas, and I'm very happy with the activities. The nine months is a 5.2% growth, which is very good in today's market in Americas; and also from a competitive perspective, a very strong number.

APAC -- well, APAC is a mixed bag as you've heard us talk about before. We are doing good in China. The double-digit growth as expected with [Sofine]. We are under pressure in some of the mature markets like Australia and Japan. No news there. We have, through the quarter, promoted [Sata] to run APAC as he's now in place, and we are quite happy with his finding and his plans for the future.

So that's the overall business. Strong growth is the message. If I then dive into some of the specialty businesses. Specialty Professional, again, in line with expectations, but a little bit lower growth this quarter compared to our year-to-date performance. However, it's important to look at the four businesses separately.

I'm very happy with what we see in our IVACs. Again, good, solid growth. Very strong earnings as always in that segment. Very healthy gross profit as well. So not much to add. It's just a great business.

Our small, outdoor -- sorry, our small food business is doing well -- as well. And then we have the normal two troublemakers in Outdoor and Restoration, and it is still challenging. And I guess for most of you, it is no surprise that we are looking at what to do with these businesses under a strategic review and we are streamlining and of course weighing our options with these two. One of the activities we've taken is to simplify our production setup on Outdoor and make sure it got its dedicated sites for that.

So that's Specialty Professional. And then let's talk a bit about the consumer business. It is a challenging business and we had a horrible quarter with a negative growth of 13.9%. Again, the reason is different from what we talked about before. No, it's not. We lost a major customer, it's been haunting us the first nine months of the year and then on top of that, we had a few orders that actually moved from Q3 into Q4.

So, it's just a very competitive market and we are doing what we can to stabilize first of all the sub-line and then we have improvement activities going on to improve the bottom line. That's in a nutshell what's going on. We believe we've now worked ourselves through the worst part of this and we believe that we see better numbers moving forward.

So that's from a market perspective, what we're looking at, and then I would like to hand over to you Karina to dive into the financial view, please.

Karina Deacon^ Yes. We'll go straight into discussing the EBITDA margin. As Hans have said in the beginning of the call, there was absolutely no surprises to us in seeing that we ended up at 8.9% for the quarter. This was expected and fully in line with what we saw already from the beginning of the year.

However that being said, it is a significant drop from Q2 to Q3 from the 12.8% to the 8.9% and if we just give you some highlights what I see is the overall explanation for that, one of them is purely a mathematical thing. If we take the overhead impact, it accounts for 1.5 percentage points of the 4% decline. This is simply because Q3 is lower in terms of revenue so when we measure in ratio terms, it has the mathematical effect. As you know our activity level in Q3 is somewhat lower than the other quarters due to holidays, et cetera. So this is not an unusual thing to see, but when we compare Q2 to Q3, it has an impact.

That leaves us with 2.4 percentage points change in the gross profit margin and where does that come from? We've talked a lot about private label sales and if I put into nominal terms just to give you a perspective, its 2.4 percentage points is about EUR6 million and about half of that comes from the effect of private label sales. So the private label sales increase from Q2 to Q4 had a significant impact. If you then look into Q4, which you might want to ask me about later, I'll say this going to be at roughly the same level in Q4 as it was in Q3 in terms of revenue.

Then we also had some other individual orders and as you know, we are running a business so sometimes we will expect a large order which has a lower margin than other orders and we had a few of those in the third quarter of the year. And then we had a slight impact from raw materials, inbound freight, et cetera, that we've talked about previously as well. So this is basically why that we saw the change from Q2 to Q3, but I'd like to say again, it was no surprise to us.

Let's turn to look at working capital. It's getting more and more difficult for me to say that the sustainable level is above [17%] because we keep being below, but nevertheless, it's still my belief that we will see it go up over the coming months. In Q3, we were helped like we also were to a certain extent in Q2, but it continued in Q3. We were helped by -- we had a high production level in China, and in China, we had a long -- a good payment towards our suppliers so it brings down our working capital. Because if we look at the other two components in the equation, the big impact from inventory and accounts receivable, you'll be able to see a big change in that.

If we look at Return on Capital Employed, continuing the good trend that we've seen, we're now at 16.5% at the end of 2017. A significant increase compared to the same period in last year.

Let's turn to look a little bit on the Accelerate+ program. We have and we will discuss that every time that we have these calls. Looking at the numbers, there's not so much new to report, you will see that it's very much in line with what we talked about after Q2.

However, if we look behind the numbers, we've actually had a lot of activity and a lot of progress in the activities that we are undertaking at the moment. As I've told you before, what we're doing now is the real structural changes where you don't see the monetary impact in the culture where we made the actions. But will of course see them towards the end of 2019.

Let me just give you a few examples of what we are working with. We have talked about that we're looking to outsource half of the finance teams; the transactional part of finance, we are moving to India after having signed a agreement, a framework agreement with [Wipro].

We have now started -- we started in Denmark which covers the Nordics and then we also looked at Benelux and we have now made the work that needs to be done. And we know what we will [change] out there and we will go live in November having the Indians helping us with that.

That program will then roll out to other countries as well. If those of you who have worked with this before knows that it takes some time and it's a lot of effort and hard work in each individual country. So this is something that we will work with the next couple of years.

Another initiative which is a bit similar to that is our consolidation of customer care factions. That's another structural change we're making. We have a sort of two tracks in that. We have consolidated some local teams for customer care for instance in the U.K., Germany, Nordics. But in addition to that, we also moved certain tasks to our own shared service center in Hungary. We have started the transfer offers certain tasks from the U.K. and Benelux and [if] so we're going as we expected.

Looking at the footprint, we have also progressed with that. We did talk about after Q2 that we had what we call [dense space]. Our production unit in Singapore, we are working with that and that work continues so we are on track for closing that down.

The other thing we have put in place or start to work with is what we call our European restructuring, which includes that we simplify our structure by -- is decorating our outdoor production on two sites. We have already in Brøndby in Denmark dedicated outdoor site. But in our Italian site, we have both floor care and outdoor products. We're now moving the floor care products to Hungary and we are thereby having a more simple structure.

Finally, what I would mention is the pricing project in the U.S., we've gone live with that. I talked a lot about it after Q2 and on our [C&P], so I won't go into much detail just saying that we are now running fully and we are following that very tightly with very, very detailed activities to make sure that we get the [basic] that we think that we can get from such a project.

So that was -- [I went through] of the financials. Just flipping to the outlook for the year, we've already talked about this. We have more visibility now being here in the middle of November, so we feel confident to narrow our range for organic growth from the 2% to 4% to 3% to 4%.

On our EBITDA, we feel confident about the raise that we have stated previously between 11% and 11.5%. So that concludes what I would like to say.

Hans Henrik Lund^ Thank you, Karina. And that takes us to the summary and I'm happy to open for Q&A.

+++ q-and-a

Operator^ Thank you. (Operator Instructions) Our first question today comes from Kristian Johansen of Danske Markets.

Kristian Johansen^ Thank you, so my first question, it's regarding the U.S. If I read the report correctly, revenue is declining in the U.S. in Q3 mostly a -- it's a tougher comparison, but can you give a bit of flavor on the underlying segments. Does this mean that revenue within national accounts is also declining or how should we read this?

Hans Henrik Lund^ Very good question, Kristian. It's a little bit -- I can't give you a strait answer because it's a little bit across the board. We've seen a little lower in national accounts, it's the same in industrial, it's the same in commercial. So it's not one segment this quarter that's sticking out.

When I looked at the activities in national accounts that we follow closely of course, the momentum is still there. We're still having orders come in to the tune we expect. So I seem confident that what we've started in U.S. will continue.

As I've said along we feel clearly we have fixed national accounts, and we still feel that after Q3, as strongly as we did before. We have work to do mainly in the industrial segment. That is the work we are doing every single day. So with that, there is really not any big news question on the topic.

Kristian Johansen^ Okay, that's clear. Then my second question is regarding the margin obviously, you explained the effect from private labels fairly well. Can you just update us on the development in raw material and freight costs. Sort of going into Q4 as well as so the trend you have seen in Q3, which clearly weighs down. Is that continuing and technically how does that come into your consideration in terms of sale prices going forward.

Karina Deacon^ Let me just answer the Q4 first. We don't see further increase in raw materials from Q3 to Q4 as of where we are today. So I don't expect that that will have an impact on the GP between the two quarters. Freight, highly little bit of a change, but to the tune that is not something I will mention if it stays at the level that we see right now.

Then the -- your other question is how are we going to get the customers to pay for this? And of course we will do our utmost to get the compensation for the raw material price increases that we've seen in this year. So when we go out first of January which we normally do, we will of course remind our customers about this increase, but it's business and whether we can get full compensation remains to be seen. But of course, we do whatever we can.

Hans Henrik Lund^ And this time, it might be worth just mentioning what [Tenant] sets on their call, that they would go for price increases -- significant price increases. So maybe -- just maybe we can afford to be a little more optimistic than we normally are on how much we are actually able to bring home.

Kristian Johansen^ Okay, that's fairly clear. And then my last question. The financial -- medium financial term target you presented on the (Inaudible) on organic growth of 3% to 5% per year. Does that mean that we should expect you not to guide below 3% organic growth next year, or is there a scenario where that can come in play?

Hans Henrik Lund^ That's a perfect question, obviously, we are not going for 2018 at the moment and the mid-term guidance has nothing to do with 2018. So you've got to the math Kristian and say, look, they're delivering above 3 % this year. They have a midterm that is 3% to 5%, so let's see.

Operator^ (Operator Instructions) Our next question today comes from Casper Blom of ADG.

Casper Blom^ I have a question regarding the Accelerate+ program, and first of all, thanks for the very detailed table that you're providing us with. When I sort of try to do the math and take sort of a roughly middle of the road approach to your guidance. I'm looking at an EBITDA improvement of let's say around EUR5 million year on year from 2016 into 2017. And as the Accelerate+ chart shows, you're there looking at an improvement of EUR17 million to EUR18 million in 2017. Can you sort of [which] the difference there, those a little more than EUR10 million. How much of that is due to you not being able to recover raw materials. How much is due to private label, et cetera? That's my first question please.

Karina Deacon^ I just need you to repeat the first number you said about the -- where you got the difference of EUR10 million.

Casper Blom^ No, I'm just saying that if I take your guidance range, I'm looking at an EBITDA this year of let's say between a [EUR122 million and EUR125 million]. So that's roughly a EBITDA improvement of EUR5 million this year compared to 2016 where it was EUR117 million. So I'm just thinking how does that respond to these EUR17 million to EUR18 million that the Accelerate+ program suggests you'd be booked this year.

Hans Henrik Lund^ Okay, now, I'm with you. What I will do if I were you, I would take the 2016 and remember to add inflation when you look at the overhead cost. And then you can take out the impact from Accelerate+. And then we did also a few selected investments, a few individual decisions that either were done deliberately or something that impacted us going from 2016 to 2017.

For instance, we had a change in the way that we accounted for R&D costs, et cetera, so there's a number of things in that. But I think it's an absolute fair question because there are -- apart from the Accelerate+, there are things and there will be things that go each way. And also as we said before looking into 2018, you will -- you can calculate the effect also from this table from the Accelerate+, but we will also make some further investments in the business, which we will talk about when we talk about the 2018 outlook later on. But this is -- there are individual components in that and we will -- we'll try to going forward to be very clear about where do the things come from.

Hans Henrik Lund^ Yes, and Casper, we will literally report it separately and say this is the Accelerate+ program and this is the other effects and we keep them separate, so that you will see that we execute Accelerate+ as planned.

Casper Blom^ Okay. So the way to think about it is really not just to take the number from the table on Page 11 in the slide pack and just add on the [active] earnings, but also to include a negative impact from inflation, investments, et cetera?

Karina Deacon^ Yes, exactly. And just bear in mind that when I was presenting at the [CMD], I was brave enough to say that when it comes to 2020, you will see [EUR35 million] in delta on the bottom line after all the inflation and investments, et cetera. But in each individual years, you have to take further things into the equation.

Casper Blom^ Okay, that's fine. Then Henrik you mentioned that -- talking about the specialty segment I think especially on the professional side, you mentioned that you're doing a strategic review, is that something that you will sort of come back with on sort of give us an update on? Is it something that could potentially lead to a divestment or closure or what's sort of the aspect of that? And timeline also please.

Hans Henrik Lund^ Yes, timeline is hard, Casper, to be honest, but all options are on the table, that's clear including divestment. And we will obviously keep you updated, we're not running any formal processes at the moment, so there's nothing to say about that. We are in the search and to talk to people phase at the moment and we will keep you updated on it.

Casper Blom^ Okay, but is it correctly understood that it's only the Specialty Professional segment and not the Specialty Consumer segment where you're doing this review?

Hans Henrik Lund^ That is correct.

Casper Blom^ Okay. So we should still expect the consumer business to be part of Nilfisk going forward?

Hans Henrik Lund^ Yes.

Operator^ (Operator Instructions) We'll now take a follow-up question from Kristian Johansen. Please go ahead.

Kristian Johansen^ Yes, thank you, just actually following up on that last comment. So why is it that you're not doing a strategic review for Specialty Consumer, I mean it's lost making this quarter. Are you confident that you can turn that division into an acceptable profitability?

Hans Henrik Lund^ Let me add some more meat on that [bone] question, thank you for following up on it. There are different parts of our business, right? Outdoor and Restoration are so separate businesses and they have a size of our total turnover that makes it a bit easier to deal with, so to speak. I'm very aware that the consumer business -- we have customers that are doing both professional and consumer for us, it's not many, but there are some. First, let's be clear the consumer business carries the DNA of Nilfisk, so it's a way bigger decision to look at that piece. And on top of that, we have a plan for consumer where we can see how we can improve it. And [Thomas] and the team are working hard to do it and I think we need to give them some time and see how that goes. And hopefully, we get it the right way. Ultimately, if we don't and if the market becomes worse then we're going to end in the same place.

Kristian Johansen^ Okay. And just so I understand, how integrated is that part of the business? I mean can it be divested or is it a matter of closing it down, is that the alternative?

Hans Henrik Lund^ That's the beauty of what Nilfisk has done over the last year or so. It's been carved out, it's been run by (Inaudible) team at the moment and that's a good change, so we get much more visibility and we get very, very clear targets for that team. There is still a bit of it that is integrated in the backend of the machine when it comes to manufacturing and stuff, but in general it is a carved out unit.

Kristian Johansen^ Okay. And then just sort of the last question on this topic, you obviously highlighted you've lost one customer -- a large customer, how big is your large customer dependency of the concentration of customers in this division. I mean, is it pure large customers or is it more diversified?

Hans Henrik Lund^ No, it is more like diversified. And we land new accounts everyday, but there are just a few, when you lose one of those, it's painful. But it's retail business and in retail business, you fight every day and you discuss marketing contributions and all kinds of things and the margins are slim. And that means sometimes you just have to say, I will not pay for your business. And that's what we did. So, sometimes you just have to go with one of those. But, again, the team is fighting every day to find new



customers and there is an improvement plan in place that we believe in. Ultimately, let's see how that goes.

Operator^ Thank you. Our next question comes from the Claus Almer of Nordea.

Claus Almer^ I have also a few questions. The first questions is for you, Karina, the comment you made about the private label in Q4, I didn't get all the details. Would you be so kind to repeat what you said?

Karina Deacon^ Yes. Maybe I didn't say it clearly, but what I meant to say was that the level of activity sort of measured in percentage of the total business in Q3 from private label will be about the same in Q4. And as you recall -- as you recall Q4 in 2016, we had a big impact from private label. That means that the delta from 2016 to 2017 is close to zero.

Claus Almer^ You mean on the gross margin, on the EBITDA margin or what do you mean (multiple speakers) --

Karina Deacon^ In the level of revenue [thus far].

Claus Almer^ Oh, in that way. Okay. Perfect. Then a second question goes to the raw material headwind. How much increase do you see here in second half on the raw material?

Karina Deacon^ Compared to the first half?

Claus Almer^ Yes. Or in other words, how much do we need to raise prices to fully compensate for this headwind?

Karina Deacon^ We have not disclosed the exact number of that. What I can tell you is that we started to see the increase sort of match. So, the first half, we had four months impact; and obviously the second half, we had six months impact. But we've not stated the extent of the increase.

Claus Almer^ Would it be fair to assume around 2 percentage points, would that be in that magnitude or would it be more?

Karina Deacon^ I don't think I'll go down that route.

Claus Almer^ Okay. It's worth trying. Then my final question goes with this restructuring of the Outdoor segment. How will that impact the numbers and how should we think about this progressing in the coming quarters?

Hans Henrik Lund^ Honestly, Claus, I would love to answer the question, but it is too early. I just cannot tell you and it's not like we're doing a major, major restructuring internally. The unit is kind of separate anyway. So, it's not like that. And then we will

see -- we will see what is the solution and what's the market like for this. And quite frankly, at the moment, I don't know.

Claus Almer^ Okay, maybe another way to ask, how much of direct is outdoor today to your profitability?

Hans Henrik Lund^ Let me just say that it's loss making.

Operator^ Thank you. (Operator Instructions) There are now no further telephone questions in the queue, so I'd like to hand back to our speakers today for any additional or closing remarks. Thank you.

Hans Henrik Lund^ Only a very fast closing remark. Thank you for joining. It's a pleasure having you here and thank you for the people that ask questions. It's always good to have a chance to talk more about it. So, thanks a lot and have a good day.