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Metsa Board: Interim Report for January-March 2016
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C: Mika Joukio; Metsa Board; CEO
C: Markus Holm; Metsa Board; CFO

P: Antti Koskivuori; Danske Bank; Analyst
P: Linus Larsson; SEB; Analyst
P: Mikael Doepel; Handelsbanken; Analyst
P: Harri Taittonen; Nordea; Analyst
P: Mikael Jafs; Kepler Cheuvreux; Analyst

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Mika Joukio^ Dear participants, welcome to Metsa Board's First Quarter 2016 Results Conference Call. My name is Mika Joukio and I'm the CEO of Metsa Board. Here with me, I have also our CFO, Markus Holm, and Head of Investor Relations, Katri Sundstrom.

Let's start with the key points in the first quarter. Market situation in our main market areas remain stable. We saw a healthy demand for folding boxboard and white top linerboards both in Europe and in Americas. The price levels in paperboards remained stable, but the pulp prices declined.

Metsa Board's paperboard delivery volumes kept growing and reached a record high level. Operating result according to our guidance remained on the same level as in last year's quarter four at EUR35 million. I will come back to the reasons for this later.

Our operative cash flow turned negative mainly to the changes in working capital which were related to Husum investment program, and our balance sheet remained strong.

Earlier today, we announced to start an efficiency improvement program in Husum integrate. Target is to cut annual costs at least by EUR10 million and we expect the impact already this year.

Our new folding boxboard machine in Husum started in February, a little late from its original timetable. As expected, the production volumes have been low in the start-up phase and during the first quarter. I'm very happy though that required product quality targets have already been reached clearly earlier than we originally expected and the production volumes are constantly increasing. However, the start-up phase will still impact our second quarter result, and the [start-up grades] will push down our average price of folding boxboard.

First deliveries to the U.S. have already arrived. For the whole year, we target to sell 200,000 tons of new folding boxboard to Americas and food service packing globally.

The total capacity of this new folding boxboard machine is 400,000 tons and we expect to reach that fully by the end of this year. And finally, the change from a paper to a paperboard mill in Husum is now completed.

On page four is the quarterly development of sales and result. As we can see, sales have declined and this is due to the significant decrease in paper sales. However, from second quarter onwards, we expect sales to grow again. And the result remained on the last quarter's level.

Then a closer look at quarter-on-quarter changes in operating result, the start-up of the new folding boxboard machine in Husum in February resulted in low production volumes in both pulp and folding boxboard which have a negative impact on our result.

In pulp, we lost some 25,000 tons of production. Also, lower market pulp prices weakened our result. Prices in long and short fiber pulps declined some 3% to 5% compared to the previous quarter. And as we have earlier mentioned, we benefit from high pulp prices.

The unprofitable paper business which is fully reported in non-core operation segment reduced significantly. This improved the non-core segment's result compared to last quarter. And due to the decreased paper production, some fixed costs and depreciations were reallocated from non-core to paperboard segment.

Our paperboard deliveries continued to grow. Compared to previous quarter, they grew by 4%, and compared to Q1 2016, we saw a 10% growth. And as I said, the delivery volumes were all-time high levels in the first quarter.

We have an ambitious but still reachable long-term target to grow annually by 13% on average from year 2015 to 2018, and I'm confident that we will reach that target. In fact, our annual average growth rate has been 9% here in past five years and 11% past three years. In the coming years, we will see growth mainly from Americas, but of course Europe as a home market is very important market for us too.

Return on capital employed was 8.3% and EBIT margin, 8%. Of course, this will change as we get the production volumes and the deliveries in the full speed from Husum. Our target is to exceed 12% level in ROCE, return on capital employed, in 2017.

Then to the paperboard segment, sales development was stable and in line with previous quarters. In addition to low production volumes in Husum, the paperboard segment's result was negatively impacted by declining market pulp prices, increased depreciation and fixed costs. Metsa Board has been delivering pulp to Sappi Company since 2009. This so-called pulp trading ended in first quarter. This has no impact on Metsa Board's result, but it will decrease our sales by roughly EUR60 million in 2016.

Then to our paper business, on non-core operations, which is getting smaller each quarter. Paper deliveries continue to decrease and segment's result improved by smaller

depreciations and fixed costs. As we estimate now that whole paper production will end already in 2016; whereas, our previous estimate was that it will be discontinued fully by end of next year, so 2017.

Foreign exchange rate changes had only a slight negative impact on our operating result in the first quarter. As we have stated earlier and as you can see it on the graphs here, our biggest exposure is in U.S. dollar.

On slide 11, you can see the development of our cash flows. The green chart is operative and black chart is the free cash flow including the impact from investments. Our quarterly operative cash flow was negative, the main reason for that being the Husum investment program. The inventories grew and also the accounts payables got smaller as the Husum investment is basically finalized. Due to growing paperboard volumes, we expect the working capital to rise further in second quarter.

Our balance sheet remained strong. At the end of review period, our equity ratio was 44%. Our net gearing rose to 42% due to the rise in interest bearing and net debts. Net debt to EBITDA ratio was also on a good level being 1.5. Our gross investments were EUR54 million in the first quarter and depreciations were EUR23 million. Our full year investments expected to be some EUR135 million which will include the equity investment in Metsa Fibre's bioproduct mill, EUR25 million. This will be made in the second quarter this year.

Full year depreciation is expected to total EUR105 million. So the Husum investment program is now completed and here are once more the impacts of this program. Total investment value is EUR170 million. We expect to see a positive impact on our annual operating result of EUR50 million starting from 2018. As you can remember, we have said that one third of this will materialize already this year. This remains still our target, but currently it looks a bit more challenging to achieve mainly due to the low production volumes in folding boxboard and pulp in Husum.

Then to the outlook, we expect the healthy demand in fresh forest fiber paperboards to continue. Our total paperboard delivery volumes are expected to grow from the first quarter levels. Start-up phase including low average price of new folding boxboard from Husum related to start-up volumes will still have an impact on our second quarter profitability. Also in second quarter, we will have maintenance shutdowns in all Finnish mills except Kemi and this will have a negative impact on second quarter result compared to the first quarter. And we expect our total production costs to remain stable. So based on these assumptions, our guidance is that operating result, excluding non-rec items, is expected to remain roughly on the same level as in first quarter 2016.

And to summarize, our first quarter result was on the same level as in last quarter last year. Our sales decreased due to the significant drop in paper deliveries as planned. Metsa Board's sales are expected to grow from second quarter onwards as the new folding boxboard volumes are starting to replace the missing paper volumes. The total delivery volumes in paperboard were at all-time-high level. In Finland, our paperboard

mills, all of them were operating at full speed. The new folding boxboard machine in Husum started in February and we have achieved the required quality targets faster than originally expected and the production volumes are steadily growing. And when it comes to the market, we can see the demand for forest fiber paperboard to remain good and price level stable.

Ladies and gentlemen, thank you for your attention. We are now ready for your questions.

+++ q-and-a

Operator^ Thank you. (Operator Instructions) And we will now take our first question from Antti Koskivuori from Danske Bank. Please go ahead.

Antti Koskivuori^ Yes, thank you. First in Husum, if you could elaborate a bit what kind of a contribution on EBIT line that the machine had in Q1, and if you have a quite positive volume outlook for that unit, could you give us an indication when do you expect that machine to be on a breakeven level on EBIT-wise? That would be my first question.

Mika Joukio^ Okay. Markus Holm will take this.

Markus Holm^ So the question was on the contribution on EBIT line in quarter one and when to reach breakeven if I understood the question right.

So first of all, in quarter one, if we look on the sales and production, both were quite small still on the line in quarter one, so production was roughly 20,000 tons and sales only 2,000 tons on the line in quarter one, so really low level to start with. Now the ramp-up is proceeding well, and production and sales are increasing steadily. And we have said that we roughly need to achieve 50% utilization, [the line], so roughly some 200,000 tons run rate on the line to reach a breakeven on that.

Antti Koskivuori^ So you're basically expecting this year to be on the breakeven level from that unit, is that the right assumption?

Markus Holm^ So when reaching the running rate of some 200,000 tons, yes, that is the breakeven level on that line roughly.

Antti Koskivuori^ Yes. Could you talk also a little bit about the quality? Now, you say that that you have reached the qualities that you have targeted, yet still you expect to have some lower average sales price, then I guess which would be the case when fully up and running? And two, can you talk a little bit about that?

Mika Joukio^ Yeah. For example in March, we already made some 70%, 80% at this premium quality, so the remaining 20%, 30% was only this so-called B grade as we call it. But naturally, you need B grade in order to run the machine and the production line up. And now, we were able to reach the A quality much, much earlier than we originally estimated and that is of course for us a very, very good news.

But still, we have this B grades to be run because we have promised that to those customers and we need to fulfill those orders. But day after day, week after week, our quality situation is improving and production level also. But we have reached the quality targets already late February or early March, and as I said, lion share production in March was already A grade where the price levels are so-called normal, and now that volume is already shipped to the U.S. The first orders delivered to customers.

Antti Koskivuori^ Okay. Thanks. Lastly, on the efficiency program that you talked about the EUR10 million, do you expect non-recurring costs to arise from that program?

Mika Joukio^ Yes. That's a bit too early to tell or to know actually because the progress started practically today when we announced that at the mill. Of course there has been preparation work, but as I said, it's a bit too early to say whether they will be non-recs or not. But the overall target is to cut costs by EUR10 million and all the means are in the toolbox.

Antti Koskivuori^ Do you have a date for when you expect to be fully on that run rate of EUR10 million?

Mika Joukio^ You mean annually EUR10 million less? That's again too early to say, but I would say during the third quarter.

Antti Koskivuori^ All right. Thank you very much.

Operator^ And we will now take our next question from the Linus Larsson from SEB. Please go ahead.

Linus Larsson^ Yes. Thank you very much and a good day to everyone. Maybe if I can start with a follow-up on the realized pricing in the paperboard division in the first quarter and it looks as if the price mix was a negative 4% as you compare Q1 to Q4, and you say that Husum contribution in terms of tonnage or sales was very small, could you talk a bit about that price mix negative that we saw on the first quarter? I understand to some degree it's explained by pulp but is there anything else which we should keep in mind? And most importantly, how should we look at this in Q2 and Q3?

Mika Joukio^ Yes. So concerning the average prices, average price does not tell the whole truth. We need to remember that we have different kind of products, I mean different grades. For example, in the linerboard, we have coated grades and uncoated grades, and the price of coated grades is much higher than uncoated grades, so the mix really plays a big role there.

And as far as the folding boxboard is concerned, if you compare our highest-priced products and then the lowest-priced products, it's easily more than EUR150 put on difference. So of course, the mix plays a very important role here. But if you just compare apple to apple, price level was stable. But the mix of course plays that role.

As far as the development in the second quarter and third quarter is concerned, we have announced price increase for linerboards to EUR50 from 16th of May onwards for coated and uncoated grades, and that's something which is in progress at the moment.

As far as the folding boxboard prices are concerned, of course we need to be ready to act if we [see-saw], but no decisions at this point.

Linus Larsson^ You previously talked about the potential negative effect from B grade qualities coming out of Husum on the price mix, is that still ahead of us? Should we expect lower average pricing in Q2 versus Q1?

Mika Joukio^ If you take the Finnish mills, no reason to say that the prices will be lower. But if and when you take Husum, of course during the first quarter, we produced a lot; we didn't sell practically, just a couple of thousands of tons. And now we will sell much, much more during the second quarter and that volume will include also so-called B grades where the lower -- prices are lower. So the average price from Husum is not the same as from Finland due to that fact, even though the A grade prices are comparable to Finnish mills and Finnish prices. So during the second quarter, we will see B grades and that will have negative impact for Husum.

Linus Larsson^ Yes. Okay, that's clear. And could you share with us how big the B grade commitments are to your customers? Could you put a tonnage figure on that for 2016?

Mika Joukio^ It's a living figure because we try to produce as more quantity as possible. But originally, we have promised and our target was, when we started the machine in February, some 15,000 to 20,000 tons of that kind of B grades.

Linus Larsson^ Okay. So it's pretty limited actually in the bigger scheme of things?

Mika Joukio^ Yes, you're right.

Linus Larsson^ Okay. And then one completely different question on the maintenance, you say you will have more maintenance cost in the second compared to the first quarter, how much more of maintenance cost you expect sequentially?

Mika Joukio^ In rough figures, when all the mills in Finland are having maintenance standstills, if you compare second quarter to first quarter, the difference is about EUR5 million.

Linus Larsson^ And then I guess in Q3, it will be less maintenance again, then you have the Kemi stuff that you put, but even so you should have lower maintenance cost in Q3 than Q2.

Mika Joukio^ It remains to be seen. Of course, Kemi's maintenance shutdown is always bigger because there is pulp mill included. But at this point, I would say pretty much of the same level.

Linus Larsson^ Sorry. So Q3 and Q2 roughly at the same level?

Mika Joukio^ Most likely lower than in second -- third quarter.

Linus Larsson^ Slightly lower on Q3?

Mika Joukio^ Yes, precisely.

Linus Larsson^ Yes. Thank you. Good. And then maybe just going back to your earlier press release from this morning regarding Husum, just one phrasing that you're using there, you said that the company will also begin charting the options for further development of the Husum mill. Could you just talk a bit about what is it that you're trying to tell us about the future for the Husum integrated mill?

Mika Joukio^ Yes. As I have said several times that there will be also life after this Husum investment, and then now we are looking for options especially in Husum on how to develop that site, whether it's pulp mill, whether it's board mill, whether it's board. I mean, all these parts inside that mill integrate are now in focus, and we will tell when we have decisions. But now we're just going to tell that we go through different options to develop that site, whether it's paperboard or whether it's pulp.

Linus Larsson^ And could that even include a new, a third paper machine?

Mika Joukio^ As I said, all the options are open. But for sure not the paper machine.

Linus Larsson^ No. A paperboard machine, I should say.

Mika Joukio^ Not necessarily that much. But as I said, all the options are open at this point.

Linus Larsson^ Okay. All right. Thank you so much.

Mika Joukio^ But of course we understand as a biggest player that now we have increased capacity quite a lot, so it doesn't necessarily make sense to do something similar in the very near future. That's clear.

Linus Larsson^ Okay. That sounds good. Thank you.

Mika Joukio^ Thanks.

Operator^ (Operator Instructions) And we will now take our next question from Mikael Doepel from Handelsbanken. Please go ahead.

Mikael Doepel^ Yes. Thank you. Good afternoon, everybody. So coming back to the utilization rate and the run rate, 50% run rate and utilization for the new folding boxboard and food service board machine, which is needed to breakeven. I guess given that you are guiding for a full year run rate, the 400,000 tons by the end of this year, do you expect to reach breakeven on an EBIT level for that machine sometime during Q3? Is that correct?

Mika Joukio^ It's pretty close. Yes. But I mean operating rate is not the right word here. Okay, maybe utilization rate would be better. I mean, our target is to reach the full production level of 400,000 tons by end of this year, but it doesn't mean that we our operating rate would be 50% because that would mean that every second day, every other day we are standing still. That is not the case. So we are constantly producing there, all the book is good, and slowly but steadily we are then increasing the volumes.

Mikael Doepel^ Yes. And then in terms of foreign currencies, given the current spot rate that we have in the market, given the sensitivities, your current hedging and the hedging losses you made last year, what would you expect to be a net impact from FX on your operating profit this year compared to last year.

Mika Joukio^ Mr. Holm will take this.

Markus Holm^ Well, I guess it's early to speculate on the full year this year. But if you look on the sequential quarter one to quarter four, the foreign exchange net effect was quite small. Now, with the weaker dollar, of course there will be some negative effect but then offset somehow to some extent by the hedges. And I can only refer to what we have said earlier that a 10% change on an unhedged position in the dollar is some [EUR60 million], so it can be calculated from there more or less.

Mikael Doepel^ Okay. Thank you very much.

Operator^ And we will now take our next question from Harri Taittonen from Nordea. Please go ahead.

Harri Taittonen^ Yes. Good afternoon. (Spoken in Foreign Language).

On the linerboard side, I mean you showed that the volumes increased from a year ago and also from the last quarter. Can you explain what has happened in the global trade [clause] overall and how has your volumes to North America have developed in your target markets sort of volumes to that region?

Mika Joukio^ You mean concerning linerboard?

Harri Taittonen^ Linerboard exactly.

Mika Joukio^ Yes. So linerboard development in the U.S. has been good, no reason to say anything else. And I think the clear sign of that is also that now we estimate that we won't have paper production left next year anymore, so all paper sales is able to [history] this year, and then we are producing also in Husum only on the linerboard on that machine -- board machine number two. So that is a clear sign that that linerboard business is doing well. And now also we have announced price increases here, so it's really in a good shape.

Harri Taittonen^ Okay. I mean, if that is to do with specific quality of the coated white top because at the same time what I gathered is that there's been an increase in certain of [our] exports from North America to Europe in the brown grades at least, that hasn't affected your development?

Mika Joukio^ No way, [I doubt it].

Harri Taittonen^ Okay. Well, maybe if I can ask about what you're seeing in the long fiber pulp market overall, in the report you sort of stated that the supply and demand looked quite stable, but what are you seeing in the pricing for the ongoing quarter given that price increase which the Metsa group have made earlier?

Mika Joukio^ So concerning pulp prices, we are slightly positive. So we see that now the long fiber prices are in the bottom and producers have announced price increases, and our estimation is that now prices tend to increase again.

Harri Taittonen^ Okay. Excellent. Many thanks.

Operator^ And we will now take our next question from Mikael Jafs from Kepler Cheuvreux. Please go ahead.

Mikael Jafs^ Yes. Hello. Good afternoon, everybody. Just a question regarding your new Husum mill and your statement where you said Europe is still your home market, so from this Husum mill, how are you thinking about -- I know that short term, you have told us that your target is to sell 200,000 tons to the Americas and outside in the world, but how large part of this capacity do you expect to stay home in Europe? That's the first question and long term that is.

And then second question would be -- I mean, we can see that pricing for cartonboard of the SBB grade has gradually been [inflicting] if we look to the PPI Europe and [addressing] price tables, how does that affect you?

Mika Joukio^ Okay. First of all, this Husum and Europe, so the story is the same. Now our target is that our Finnish mills are serving Europe, and then Husum is serving North America and whole Americas as far as so-called normal folding boxboard is concerned.

As far as then the food service business is concerned, then there is another important business for Husum and that business is global. So we are serving the U.S. with our

normal -- so-called normal folding boxboard, and then we are serving global markets including Europe as far as the food service segment is concerned. But the so-called normal folding boxboard business in Europe will be served from Finland. That is a very clear statement, so no reason to change that.

And of course then that would mean that for Husum, Europe is not necessarily the most important market. The most important market will be the U.S. market. But for the company of course, home market is Europe. But there is clear division between Finnish mills and Husum, and that is also crystal clear for our sales and our production guys.

As far as then the prices are concerned, okay, SBB price -- SBB as a product is not that competitive as folding boxboard when we think yield and that kind of things. And please remember that we have been able to grow our business in Europe more than market has grown. So we have, one, the market shares from white lined chip and also partly from SBS, and that might explain the price development of SBS. We are not producing SBS, but that is our estimation. Our product is so competitive against white line chip and SBS. So that is my comment.

Mikael Jafs^ Yes. Okay. Many thanks.

Mika Joukio^ Thanks too.

Operator^ There are no further questions on the telephone at this time.

Mika Joukio^ Okay. Ladies and gentlemen, so thank you very much for your attention, and have a nice day and see you around. Bye-bye.