

# Nokian Tyres Q3/2023 conference call

Tuesday, 31<sup>st</sup> October 2023

**Operator:** Hello, and welcome to the Nokian Tyres Third Quarter 2023 conference call. Please note, this conference is being recorded, and for the duration of the call, your lines will be on listen-only. However, you'll have the opportunity to ask questions. This can be done by pressing star one on your telephone keypad to register your question. If you require assistance at any point, please press star zero and you'll be connected to an Operator. I will now hand you over to your host, Paivi Antola to begin today's conference. Thank you.

**Paivi Antola:** Good afternoon from Helsinki, and welcome to Nokian Tyres, Q3 2023 results conference call. My name is Paivi Antola. I am from Nokian Tyres industry relations, and together with me in this call, I have Jukka Moisio, the president, and CEO of the company, and Niko Haavisto, the Nokian Tyres CFO, who joined the company in the beginning of October. So welcome to Nokian Tyres, Niko.

**Niko Haavisto:** Thank you, Paivi. Pleased to be here.

**Paivi Antola:** And we also have Adrian Kaczmarczyk, senior vice president supply operations, who will give an update on how the expansion of Nokian Tyres manufacturing footprint and rebuilding capacity is proceeding. And that is the topic we will be starting this call with. So Adrian, welcome and please go ahead.

**Adrian Kaczmarczyk:** Thank you, Paivi. Welcome to our call today. Good morning, good afternoon to everybody. As Paivi said, my name is Adrian Kaczmarczyk and I will be talking about the expansion and the rebuilding of the Nokian Tyres capacity and the progress as such. When we start with the Oradea project, we have basically started the Romania factory project in May this year was a great ground-breaking event, and since then the progress has been quite substantial.

So we have really completed the site cleaning and the site preparation work. And the main utility building and the main production building has progressed according to plan. So we are currently, and you will see it also on some pictures later, well into 85% of the completion rate at this point of time. And as we speak now, the contractors are really continuing also with the feet out of the building inside pouring concrete and doing all the preparation work needed to start the machine installation as planned beginning early 2024.

But the main equipment obviously is now being built and everything has been ordered. And as said, we are planning to start the installation of our first equipment in the first quarter next year. The recruitment process has started. We kicked off the recruiting process, which basically will ramp up in the fourth quarter and reach its peak in the first half of next year when then – where we plan and target to produce our first tyre in the second half.

And then during the second half of next year, we will commercialise and qualify all needed production and products to be ready to start the producing and commercialising our production in beginning of 2025. In addition, obviously, we also applied for investment subsidy of 99.5 million, which basically has been filed through the Romanian government and is currently under review and under investigation by the EU Commission.

On the next slide, you will see the pictures on the left hand side, the production building as said, which is almost 80% finished. You see on the right hand side how it looks like inside and obviously, as I said, and also roofing has been almost concluded and completed. So overall, I have to say that despite all those challenges those projects bring along, we've been able to maintain our very tight timeline up till now.

Next, please. On the overall capacity, Nokian Tyres capacity, I can only say that we have been successfully concluded our capacity expansion in Nokia, Finland for our passenger car tyre production. And we are currently finalising the installation in our date in Tennessee facility, and currently commissioning the equipment.

So installations are finalising as we speak, and the ramp up of the equipment is planned in parallel with the new product introductions we are currently doing in the first half of next year. And then Dayton will operate at it full capacity in the second half of 2024, where we were then finally conclude the expansion and have also our full product portfolio ready for the North American market.

On the contract manufacturing side, we've been able to secure approximately 1.5 million tyres for mainly the Central European market. And they are split between two families, mainly winter and all season, and will be followed by summer products beginning next year. If you look at our footprint, and this is the final stage as it will look like. As you can see, we will continue with contract manufacturing as part of our portfolio.

So we call it virtual factory, but we'll operate three factories Dayton in Tennessee, US as I said, finalising the expansion in the first half next year with the complete portfolio being available for the North American market. Nokia, Finland currently operating at its capacity and Romania, Oradea new factory, well, in schedule to be ready to produce first tyre in the second half of 2024. And with that, thank you and will hand over back to, Paivi.

**Paivi Antola:** Thank you, Adrian. And for the audience, Adrian will be on the line the whole call. So he will be available for your questions at the end of this call. But then we'll continue to the actual results. So Jukka, please go ahead.

**Jukka Moisio:** Thank you, Paivi, and welcome on my behalf as well. And thank you, Adrian to take us through the capacity development stages. One year ago, pretty much, we signed the agreement to divert our Russian factory to Tatneft. And also about one year ago we announced our decision to invest in Oradea. So quite a milestone one year ago. And we've come a long way and we are actually closer to starting the factory in Oradea.

And actually it's a longer time from the decision. So we are more than halfway on our way to rebuilding Nokian Tyres. We started with about 19 million tyres in 2021 when Russia was at full speed. And then in 2022, we had an eventful year with war in Ukraine, and then various steps. And we are heading towards 15 plus million capacity when investments have been completed, plus the virtual factory between one and 3 million. So all in all that prebuilt journey is continuing and step by step achieve our milestones.

But let's move to quarter three, and this is now comparable numbers. So this means that Russia activity has been classified as discontinued operations. And so therefore, like-for-like is the comparison. Profitability improved; net sales were 276 million versus 333 million in 2022. And this is a decline of 12.7% in comparable currencies.

We had a demand in market environment and inventories in the distribution, we're on a high level. And of course, our main product offering for 2023 was really with the tyres. Obviously, we had a certain number of tyres from offtake and so on. But mostly, we had an own manufacturing manufactured winter tyres. 50 million negative impact from currencies. Market share gains, we have seen market share gains in three million winter tyres. And this is based on the feedback from our customers.

Our segments EBITDA at 46 million versus 7.4 million last year. This means margin of 16.7% versus 2.2% of segments net sales compared to 2022. So clear improvement in margin and in absolute EBITDA. Segments operating profit at the 19.6 million versus -17.9 a year ago. Again, there is a clear improvement, and that's driven by passenger car tyres. We also announced last week that the second dividend instalment of 20 cents per share will be paid in December.

I move to page seven. And just to reflect that we have a strong balance sheet, I call out some key numbers in the balance sheet. First of all, let's start with the capital expenditure. In the quarter, we spend about 70 million, 69.5 versus about 27 million a year ago. Year to date, our capital expenditure is in the range of 157 million. And last year, 2022, we spent about 60 million in capital expenditure.

To have a forward looking assessment of the capital expenditure. This year, we expect that we land somewhere in the range of 250 million for the full year, so about a 100 million more in the final quarter. Segment EBS earnings per share was 9 cents in the quarter versus 25 cents a year ago, this 25 cents include the discontinued operations of Russia.

In the nine months, our segments EBITDA was 12.2%, and that's an improvement over 9.3% a year ago. Also in absolute euros, the EBITDA improved on segments operating profit at 24.7 million in the first nine months versus 17.6 a year ago. And as you see, almost all of the segment's operating profit in the first nine months were delivered in the third quarter.

Our equity ratio remains good, 60.1%. Gearing is 28.2%, and it's per net debt at the end of September was 386 million. And as you remember, our cash flow profile is such that we collect a significant cash inflow in the final quarter. And with that, I hand over to Niko, our new CFO, and Niko welcome on my behalf. And please, it's all yours for the first quarterly results.

**Niko Haavisto:** Yeah. Thank you, Jukka. And I will go through the Q3 segment numbers a little bit more in the – I'm on page eight now. And as you noticed in the release that we do have lower sales compared to last year, some -16.6% in comparable currencies, but our margins are on a good level. And the ASP with comparable currencies increase slightly.

You have also noted, when we released last week, the profit warning guidance, we said there, that the inventory at the distribution are on the high level. So that's what we are facing. But on the other hand, we see a clear profitability improvement and our margins are so supported by lower costs.

On this page still, I would like to point out the segment operating profit of close to £19 million, and at the level of 11.1 percentage. Paivi, if you move to next page, page nine, there is the PCT approach, which you can see that starting from the Q3 last year, roughly 40 million was

lower of the volumes price mix. We gained £4 million and with those two elements, we were at the level of £180 million in terms of sales, but we also had the negative effect from the currencies of some 10 million euro. And with that, we landed with the segments' sales of £170 million.

Operating profit bridge there for the PCT Q3, we started from the low -18 million lever. They're the same elements, i.e., the sales volume, of course, hitting us price mix. BT got the gain there and the material prices are in our favour as well. And then there was this big element of supply chain of 40 million. And then the sales and general admin there. There we also saved some £6 million. That comes excluding the effects at the level of £21 million as an operating profit.

And then when you deduct the negative effects for currency impact there, we land at the £19 million at the PCT segment. On page 10, you can see kind of the trend we were in Q1 -63% in terms of volumes, then Q2 -30%, and now we are at the level of -18%. Price mix there, as said, we had both in Q1 and Q2, i.e., H1 this year, good development.

Now that development is more – or that favourable development is more or less kind of achieved. So we were having some 1.7 percentage there in terms of net sales gain. And then the currency in that right hand column, you see that in all quarters, that has been negative for this PCT segment.

Then briefly page 11, heavy tyres, their BC is that the net sales decrease mainly due to soft aftermarket. And also see the similar thing that the inventory levels in the after-market distribution are on the high site. Operating profit was lower due to the fact that the volumes were beat down as well as the currency BC segment as well. And then during the summer, we had the temporary adoption to our production, which reflected the lower demand in this segment. But also there, if you look at the segment's operating profit percent is 12.1%, was the number for Q3, 2023.

Page 12, beyond there, clearly see also there had been, from the currencies, from some 4.2% negative, and of course, this Q3 is seasonally a low quarter for us, and therefore, for the sales. And in terms of operating profit, they were lower than previous year and then the coming quarter as well.

And then last was the guidance that we updated a week ago on the 24, that night. And we are saying that we expect net sales between 1.15 to 1.2 billion and operating profit between 5.5 to 6% approximately of the net sales. And with that, I hand over back to you for the final conclusions.

**Jukka Moisio:** Thank you, Niko. And thank you for taking us through the financial summary. So keep on building the new Nokian Tyres. We have the long term targets where we want to go back to 2 billion in net sales and achieve a segment operating profit at 15%, and also have the balance sheet leverage at net EBITDA between one and two. And underlying there is the EBITDA target that our segments EBITDA long term will be in range of 23 to 25%.

And remember that in the third quarter, we had 16.7% and had a sequence of improvement in 2023 until third quarter. And we expect also similar sequence improvement in the fourth quarter compared to third quarter in EBITDA margin. We have five cornerstones safe tyres responsible and effective supply chain, consumer trusted premium brand, leader in sustainability. We make good progress in sustainability, come back data to that one.

And Nokian Tyres team, obviously, lots of things have happened since the announcement of the divestment of Russian factory to Tatneft, final conclusion of the deal in March this year. And then continued building of new Nokian Tyres and especially investing in Oradea and many other things happening simultaneously. So this is Nokian Tyres in summary, this is the quarter three, and the building of the company continues. Over to you, Paivi.

**Paivi Antola:** Thank you, Jukka. Thank you Niko, and now operator, we will be ready for the questions from the audience, please.

**Operator:** Thank you. As a reminder, if you would like to ask a question or make a contribution on today's call, please press star one on your telephone keypad. If you change your mind and want to withdraw your question, please press star two. Please ensure your lines are unmuted locally, as you'll be prompted when to ask your question. Our first question comes from the line of Giulio Pescatore from BNP Paraba. Please go ahead.

**Giulio Pescatore:** Hi. Thanks for taking my question, and thanks for sharing the update on the construction of the Romania plant. Can you just remind us on that of how much of the 650 million you target to spend, that you already spent this year, and of the phasing in the coming years, if there has been any update on that?

Then the second one on the winter tyre, you said the inventories are still elevated, is that still the case today, or that was more the situation in Q3? And maybe a more high level question on this. Are you seeing customers moving away from winter tyres because this is the third winter season that is described as being weak by pretty much all players.

So is there any structural changes especially, in Central Europe that you're aware of? And yeah, what actions are you taking to make sure that the market continues to grow for you? And then the last question on the raw material cost that turned into a tailwind. Any impact on pricing? Are you seeing any of your peers starting to give back some of the pricing that was taken in the last few years as raw material cost become a tailwind? Thank you.

**Paivi Antola:** If we start with the CapEx question, that goes to Adrian, and then maybe you Jukka continues.

**Adrian Kaczmarczyk:** Yeah. The project basically is phased over the next year. So we started last year in 2022 with down payments of around 50 million and some preparation work. We expect to spend 100 to 120 million in 2023, reaching its peak in 2024, around 300 million, and then coming down around 200, 180 million in 2025.

**Jukka Moisio:** And then to expect the subsidy of about a 100d million to help our investment decision on investment process. Okay. So winter tyres inventories. Yes, we saw the inventories in the third quarter, and obviously the sell-out is something that is expected to happen right now. In the Nordic countries, the sell-out is happening as we speak because the winter has come and it's getting cold and it's getting snowy and icy.

And so therefore we see that sell-out happening as we speak. And based on our [inaudible] chain, we see relatively good sell-out in the winter tyres. Then in Canada, North America, still winter is coming right now. So the sell-out is about to happen in the coming weeks and in the month of November. And there we see that the inventory reductions will happen when the sell-out takes place.

But in Eastern Europe, Central Europe, the inventory is yet to come. So the inventories at this point of time are relatively full, but then obviously we expect that the step by step that happens.

You ask that whether there are people moving away from winter tyres. I think that in the geographies where you clearly have icy and snowy conditions, you don't see that happening.

Of course, you have the selection that people may take instead of study vintage tyres, they take friction tyres or all better tyres if you go to North America, while of course in some of the Central European markets, it's clear there that the all season is taking market share from winter tyres as well as from summer tyres, and then they are being used throughout the year in the cars.

Most of the new cars come with the summer tyres and so on. In North America, new cars are coming fitted with – a lot of them are coming with all season tyres. So clearly, see that the all season is a winning concept in the North American markets. But in the areas where you have a clear winter like Canada and northern parts of the US, you clearly have a winter tyre requirements.

And so structural change is stepwise happening with the all season. And therefore, of course, it's important for us that we have all season product offering, and this is going to be one important element of our product portfolio. Unfortunately, this year, because of the loss of Russian factory, we just did not have a very good selection of all season tyres, so therefore, we're highly dependent on the winter this year.

But obviously in 2024, 2025, the uptake a new factory and new capability, we will have a much better product selection. And raw material, yes, we see a tailwind in raw material. No, we don't see price point changes yet. We see, of course, that there may be promotions here and there and so on, but across the board, price changes we don't see at this point of time.

**Giulio Pescatore:** Perfect. Thank you very much.

**Jukka Moisio:** You're welcome.

**Operator:** Our next question comes from the line of Christoph Laskawi from Deutsche Bank. Please go ahead.

**Christoph Laskawi:** Good afternoon. Thank you for taking my questions as well. A bit of a follow up to Giulio's question, just on the heavy tyre aftermarket inventory, could you comment on when you see that easing a bit as well? And then second group of questions would be on the ramp up of volumes into Q4 and 2024, which is just comment again on how the contract manufacturing is ramping up.

And in case there would be elevated dealer inventory still towards 2024 or mid-2024, how flexible are those contract manufacturing volumes? Do you have fixed volume contracts and expect to sell anything that you get anyways, or would it be flexible in terms of volatility in the market? Thank you.

**Jukka Moisio:** All right. So I'll take the heavy tyres and Adrian will talk about the contract manufacturing. So heavy tyres, indeed, we saw a significantly high inventories in the early part of the year, and clearly the deliveries to distribution were on low level while at the same time in the early part of the year, we had a relatively good demand of OE.

And so therefore, what we did over the summer is that we took extended shot in our factory in Nokia and that they managed our own inventories down. And then also the after-market inventories and heavy tyres started to come down in the first half of the year. And now when

we go into second half, we can run quite hard in our manufacturing because the inventories and the demand in inventories are lower and the aftermarket deliveries are better.

At the same time, of course, because of the higher interest rate and situations in the economy, number of OE customers when they purchase expensive equipment are considering that whether they purchase or not. And so therefore, the OE demand is getting softer and perhaps into 2024, we need to wait and see how that fully will develop. But clearly the high interest rates have an impact. But overall on balance, we see a relatively good run rate for heavy tyres in the final quarter, and that our inventories are well under control and it's driven by aftermarket and be relatively flat in the OE. But over to you, Adrian in terms of offtake.

**Adrian Kaczmarczyk:** Yeah. On the offtake side, it's also shown on the virtual factory, we have purposely built sufficient flexibility in the contracts which allow us to respond to market demand variations. So we have started the contracting with a volume of roughly 1.5 million for winter. And all season will be followed by summer.

And the range we are expecting to source from contract manufacturing will be between 1.5 and 3 million. And this really depends on the demand development. So we have sufficient flexibility to respond to the to the market demand based on the rolling forecast we are providing to our contract manufacturing partners.

**Christoph Laskawi:** Thank you.

**Operator:** Our next question comes from a line of Mika [inaudible] from DNP Markets. Please go ahead.

**Mika:** Hello. Thanks for taking my question. So you mentioned that based on customer feedback you've maintained or further improved your market share in premium winter tyres. Is it still fair to assume that there was still considerable down trading to lower tier winter tyres this year? Meaning that as aggregate, you lost market share against lower tier players? And if yes, can you a little bit help us to understand how much of that sales decline in passengers car tyres was driven by high inventory situation in distribution and how much due to actual down trading?

**Jukka Moisio:** That particular balance is difficult to say, but it's clear that what happened is, especially, for example, in the Nordics, is that based on our own manufacturing, we had a good availability of premium with the tyres and clearly because of the lack of capacity, we had less available to P category and so on. What happened was that, for example, we are now – were able to secure third party offering to our operations, and therefore obviously we are not top line.

The sell-out is continuing at a good level or stable level. And the mix is then consisting, of course, of our premium tyres, but also at the same time, from purchase or outsource tyres to ensure that the outlets have a good selection, a good portfolio for all the customers. How much that, it's difficult to say. What we can say is that when we look at the premium winter tyres, our feedback is that we've gained share, but then obviously the lack of products in the peak category of our own making have been then supported by other suppliers.

**Mika:** Thank you.

**Operator:** Our next question comes from a line of Howdy Yuba [?] from Inderes [?], please go ahead.

**Howdy Yuba:** Yes. Hi, I'm Howdy from Inderes, I have two questions. I can take them one by one. And first is on your production. So now when the demand obviously was weaker than you anticipated in the winter tyres, how have you reacted in terms of production for that? Are you now able to produce more summer tyres for next year, or have you taken down to production levels or what's happening there?

**Jukka Moisio:** Yeah. It mean the passenger car tyres, we have not taken any downtime, so we actually allocate the production to different products because obviously as mentioned earlier, that yes, we had a good selection of the premium tyres and then we had no capacity for the summer tyres or all season tyres. So we actually changed the direction of the production. There's no need to take downtime.

Obviously in heavy tyres, we did take over the summer period, so we took downtime to manage the inventories. But in PCT, this is not needed. Obviously we would have a normal maintenance shutdown at the end of the year, but this is scheduled and it's normal.

**Howdy Yuba:** Yeah. That's very clear. And then secondly, you mentioned that you are planning to finish the ramp up of the US factory next year. So could you talk a bit kind of how you are planning to utilise all that capacity given the weak markets? I guess the expanded product range versus this year is one factor, but is there something else?

**Jukka Moisio:** Yeah. So first of all the technical part and how we ramp up on at will address, but basically the product selection is of course all season, all weather, and then we go into light truck, so we start the light truck production. But the technically, how does it go, Adrian? Most of that will happen this year, I guess. Then the remainder will be in early part of next year.

**Adrian Kaczmarczyk:** So technically, the technical capabilities and equipment will be the installation and commissioning will be finalised this year. Then we will need the time next year to utilise the equipment with the new portfolio and new product introductions to then fully utilise the factory in the second half of 2024.

**Jukka Moisio:** Maybe just an anecdote or not anecdote, but just an observation about the product portfolio in data was that originally, when we invested in data, we had an idea that we would be supporting data North American market with certain productions from Russia. Now, obvious even the Russia is not there anymore. So we have a little bit a change in the production portfolio there and then need to have a virtual factory way of supporting our North American product selection over time.

**Operator:** Okay. Very clear. Thank you. Our next question comes from a line of Mika Karppinen from Danske Bank. Please go ahead.

**Mika Karppinen:** Yeah. Hi, this Mika from Danske. Could you comment on the Central European market, have you lost any distribution in those market areas after the last horizon production, or was it just availability of senior products for the season?

**Jukka Moisio:** No. We haven't. We did what we did a year ago is that we actually reduced the theme quite significantly. And we also looked at the markets where we don't have any product to sale, which is basically summer markets. And so therefore, we'd get the distribution and the data, and distribution network in the areas. That's where we have a winter tyre all season and summer tyre in combination. Now, we haven't lost anything, but we were – and we've gained a market. We've gained market share in the premium winter tyre selling, but this is all we had, so no availability issues, simply high inventories and slow start into the winter season.



**Mika Karpinnen:** Okay. Good. Thank you.

**Operator:** Before we proceed to the next question, a final reminder, if you would like to ask a question, please press star one. Our next question comes from the line of Artem Beletski from SEB. Please go ahead.

**Artem Beletski:** Yes. Good afternoon, and thank you for taking my questions. Maybe I can start with downgraded, the outlook for this year. And I think you mentioned that you didn't take any downtime in terms of passenger car tyre manufacturing this year. So volume outlook should be unchanged. Is it really price mix pictures that has changed to weaker versus your initial expectations? So are you planning to have a bit high inventories, for example, by the end of this year?

**Jukka Moisio:** I think that right now the production actually focuses on next year already. So obviously what will happen is that dependent when the deliveries will happen, whether they have late this year or early next year. So that will dictate a little bit the inventory. But dictates maybe most of the inventory change at this point of time is the contract manufacturing that when they come in and how they are being supplied to customers. And those products are mostly now when we look at the coming season, they will be summer 2024 as well as all season 2024. In raw materials the inventories have come down. So we are actually quite at a good level in terms of raw materials.

**Artem Beletski:** Okay. That's very clear. And maybe two shorter questions from my side. Could you may be comment on start-up related costs? What comes to next year? I think you have some cost already relating to Romania, also in this quarter. And also the second one is on CapEx for next year. I appreciate comments, what you made relating to Romania. Could you make some indication what will be the level for next year on the group level?

**Jukka Moisio:** The start of ramp up cost difficult to anticipate at this point of time? We still are in the budgeting season and so on. Obviously we've said about the date, and then once we hit the equivalent 3 million, then we will eliminate that. But of course when we go into Romania, so we'll have certain items there, but we don't know yet how much that will be.

So we'll have a look and we'll get back to that in connection of the fourth quarter and starting of the next year in order to anticipate what they might be, but Niko.

**Niko Haavisto:** Yeah. In terms of CapEx, we are anticipating somewhere around of £350 million next year. And then we are expecting at least part of the Romania government subsidy of the £99 million to land next year as well. So if you net that against the 350, you land somewhere around 300, is the best guesstimate now.

**Artem Beletski:** Okay. [inaudible].

**Jukka Moisio:** And if you remember, our ambition is that we expect that the EBITDA of 2023, 2024, 2025 ought to be covering investment of those three years.

**Artem Beletski:** Yeah. That's very good to keep in mind. But yeah thank you for these answers.

**Operator:** There are no further questions, so I will hand you back to your host to conclude today's conference.

**Paivi Antola:** Thank you. If there are no additional questions, that means that we will be ending the call. Thank you for participating and have a good day.

**Jukka Moisio:** Thank you.

**Adrian Kaczmarczyk:** Thank you.

**Operator:** Thank you for joining today's call. You may now disconnect your lines. Host, please stay on the line and await further instruction.

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