

Nokian Tyres Q2/2023

Friday, 21st July 2023

Operator: Good day, and welcome to today's Nokian Tyres Second Quarter 2023 Conference Call. This meeting is being recorded. At this time, I'd like to hand the call over to Paivi Antola. Please go ahead.

Paivi Antola: Good afternoon from Helsinki and welcome to Nokian Tyres Q2, 23 Results Conference Call. My name is Paivi Antola from Nokian Tyres Industrial Relations, and together with me in the call, I have Jukka Moisio, the President and CEO of the company, and Teemu Kangas-Karki, the CFO of Nokian Tyres. And in this call, we will go through the Q2 results and how we are proceeding with building the new Nokian Tyres. But now I'm handing over to Jukka and Teemu, please go ahead.

Jukka Moisio: Thank you, Paivi. Jukka Moisio here. So welcome on my behalf. And indeed we have a presentation there. The heading is Building New Nokian Tyres is on Track. And so I move on that presentation to page two and talk quickly about the strategic projects. They are proceeding as planned. First of all, we have the Romanian factory. So building work is on way, and we had the ground breaking in May 2023. We got building permit on the same day, and so we are very much progressing on the building.

Main equipment, as you may remember, we ordered already in 2022, so that there is security availability and deliberate times. Our timeline is such that first tyres are expected in the second half of 2024. And the commercial production will start in 2025. Application for the investment subsidiary of up to €99.5 million is under EU review, so that they approve the state aid as proposed by the Canadian government.

Another project in Finland. So we have the passenger car tyre capacity increased and in use as we speak. In the US, the ramp up of factories proceeding. So we've hired additional employees to the production and the equipment installations are ongoing. New production lines are being studied sequentially in this - at this very moment. And towards the end of Q3 we expect that they all are installed and then we start then step by step by the end of the year.

On the manufacturing volume of 1.5 million tyres have been secured for 2023. So first internal season tyres to central European market will be in the second half of 2023. No significant minor volumes only of the contract manufacturing has been delivered in the first six months of the year. So most of this 1.5 million secured volume will be benefiting top line and the company in the second half of 2023.

I move to page three about the profitability. So all these numbers in Q2 are excluding Russia. So first of all, the segments net sales at €293 million versus €332 million in '22. This is a 12% reported decline. But if we exclude the currency impact, so 7.3% decline in constant currencies. Same reasons there were lower passenger car tyre supply volumes. This is a reflection that we

did not have the full capability to deliver in the early part of the year. We get additional tyres, additional volume in the second half, and that will help our top line.

Also, the car and tyre market environment for the replacement tyres they're quite demanding, including also the currency headwinds, which we experienced mostly versus the Euro in the Nordic markets. So Norway and Sweden. Norway being the most or the biggest headwind in terms of currency conversion.

Segment operating profit at €50.2 million versus €0.9 million in '22. Price increase is to combat cost inflation led to higher ASP. Segment's EBITDA was 41.3 million versus €25.9 in '22. So we reported 14.1% segment's EBITDA versus 7.8% in '22 in the corresponding quarter.

Move to page four. Here are some of the key financial numbers. I call out some key numbers that didn't mention earlier. So segment's operated profit at 5.2%, segment's EDITDA at 14.1% and a small earnings per share for €0.5 cents per share in the quarter. And if you look at the capital expenditure, we spent €3 million in the quarter versus €19 million prior year. And cash flow from operating activities was minus €67 million versus €109 million a year ago.

In the first six months, if you look at the top line, so all in all, we had the reported change of a minus 19%, so €529 in '23 versus €655 in '22. In constant currency, the change was minus 16%. Segment's EBITDA for the first six months in '23 was 9.9% versus 13% in '22. And as mentioned in our guidance that the segment's operating profit was up €1 million, and we said that the profitability and profit of '23 will be generated in the second half of the year. However, we are at €1.1 million, slightly positive in the first half, and that compares to €35.5 million in '22.

In terms of equity ratio, we are still at high level, 60% gearing at €16.2 and interest in net debt at €220 million out of which €130 million are IFRS 16, leases. And capital expenditure in the first half, €87 million versus €33 million in the prior year. And cashflow from operating activities in the first six months, €124 million negative. Again, we experienced a strong seasonality explained by the fact that most of our products sold and our top line will be consisting of - with the tyres.

And with that, I hand over to Teemu to talk about financials. Teemu, please go ahead.

Teemu Kangas-Karki: Thank you, Jukka. Moving to the page in number five, and here we are talking about the - our diversified debt portfolio that we discussed at the end of April in our CMD. And as we speak, we are in a good position in order to secure the funding for our investment phase.

And just to call out some of the activities that we have taken in recent months, we - in May, we draw €300 million long-term bilateral credit facilities, and then in June, we issued €100 million sustainability linked five years on issue. So from here on, we are in a structured way building the debt portfolio with balanced maturity as we go to the next quarters and years. And as I said, we are in a good position today.

And then if we talk about our cashflow, as you all recall, it is our normal facing[?] how the cashflow is going. So in the first half, we are tying capital in our working capital, and then in the second half we are then releasing it when we get the payments in from our - especially from our winter tyre sales. So we are expecting to have a positive cash flow from our operating activities in the second half.

Then moving to the page number six, talking about the passenger car tyre performance. There, our net sales in the quarter was on a level of €153 million, and our segment operating profit was on a break-even level. The top line change with comparable currencies was on a level of minus 14%. And as we have been discussing earlier, the top line development is lack of supply volumes. And at the same time, we have been increasing our prices net ASP strongly during the past quarter, starting already at the end of '21.

Then moving to the next slide where you can see the passenger car tyre bridges, looking - the first net sales, here you can see that our price makes development in the quarter was in absolute terms €29 million, almost 15% in relative terms. And then if you look our segment operating profit development, naturally decline in sales volume, but then the price mix have been more than offsetting the decline in volume.

Then moving to page eight about heavy tyres, there the net sales was impacted by - so aftermarket, our net sales in absolute terms in the second quarter was on a level of €67 million with comparable currencies decline of about 6%. And then our segment operating profit was on a level of €9 million decline from the comparison period, which was €16 million.

And as said earlier, the net sales decrease was due to the inventory levels in the aftermarket distribution. They are doing the - these stocking activities, and that has an - that had an impact on our net sales, but as well as to the segment operating profit. And because of the softness in the market, we temporarily adapted the production during the summer break.

Then the Vianor business performance that was stable in overall, since our net sales was a level of €94 million with comparable currencies, there was an increase of more than 3%, and our segment operating profit remain on the same level time in comparison peer period. So yeah, you can see that there was a significant headwind from the currencies both in the passenger car tyre business unit as in Vianor business unit. And handing over back to you, Jukka.

Jukka Moisio: Thank you, Teemu. So on page ten, just to reflect that we've taken steps forward in sustainability. In March, we made the science-based commitment to achieve net zero standard by 2050 to reduce greenhouse gas emissions further. In May, we awarded the platinum medal for EcoBodies for our sustainability performance, which then places us on top one percentile of the companies assessed. And in June, we issued this €100 million sustainability linked bond, which Teemu was talking about, based on following greenhouse gas emission reduction targets. First of all, reduced the Scope 1 and 2 by intensity by 65% by 2030 from last year's base, and also reduced Scope 3 greenhouse gas emissions intensity from product used by 20% from 2022 base[?] by 2030.

Then I move on page to page 11. So assumptions for 2023, the second half of the year is expected to be supported by the winter tyre and all season tyres and contract manufacturing volume. And as mentioned earlier in this presentation and especially in the first quarter that we were lacking supply and that had an impact on our net sales pipeline and profitability.

The general economic development may have a negative impact on demand in the second half. This is something that every everybody's assessing that is still going to be a soft landing or some kind of a recessionary situation or what could happen. So that may have an impact. That is to be assessed once we go on in the second half. And then changes in the foreign currencies, and especially as we mentioned, we had a strong headwind from Nordic currencies, especially Norwegian Kroner, but also from the Swedish Kroner, as well as the US and Canadian dollars.

And they haven't - have had a negative effect on the first half and especially second quarter sales. And then if they keep on trading that way, they may have a further negative effect in the second half.

Our guidance for 2023 is unchanged. So we expect that the net sales will be between €1.3 to €1.5 billion, and the segment's operating profit percentage of net sales between 6% to 8%. And as mentioned to the seasonality, the operating profit will be generated in the second half of the year. And you recall that the first half, our segment operating profit was the first six months €1 million, and then in the second quarter, we already had a stronger performance compared to the first sequencing compared to the first quarter.

And as of 2023 segment's net sales and segment's operating profit exclude Russia and other items which are not indicative of Nokian Tyres underlying business performance, just as a reminder.

And finally, we are building the new Nokian Tyres together. So we have an ambition to go back to 2 billion in net sales. We have two different time horizons. One is to rebuild in the capacity, and the second one is then to benefit and build the market share and the volume once the rebuild and the investment phase is over.

Our financial targets long-term, so net sales in €2 billion, segment's operating profit at 15% level, and as a new target net debt segment's EBITDA between one and two terms, which means that we will have a longer-term different balance sheet compared to our history. We will expect to have net debt in the range of €500 to €1 billion depending on our EBITDA and net sales. Our EBITDA target longer-term is on range of 24% to 25%.

And these are our key messages. So building new Nokian Tyres progresses on track second quarter clearly better than the first quarter, and we expect that profit of the year will be generated in the second half. Paivi, over to you.

Paivi Antola: Thank you, Jukka. Thank you, Teemu. And now operator, we would be ready for the questions from the audience, please.

Operator: Thank you. Ladies and gentlemen, if you wish to ask a question at this time, please signal by pressing star one on your telephone keypad. Please make sure the mute function on your phone is switched out to allow your signal to reach our equipment. Again, please press star one to ask a question. Now, first question comes from Mika Karppinen from Danske Bank. Please go ahead.

Mika Karppinen: Yeah, hi, this is Mika from Danske. Could you comment a bit more about the pricing and mix develop in terms of how product area changes and then rim size changes?

Jukka Moisio: So the price mix development is a function of several factors. First the real price increase is that we have been executing diligently, as I said already starting from second half '21. And then on top of that the mix effect which is coming from product mix development, that has been also positive. As you can see in our release, that the share of winter tyres has been increasing. And then on top of that. There is a mix in positive mix impact from geographical point of view when the share of Nordic has been increasing relative to the CE. And then on top of that, the last mix impact is also the customer mix where we have been discontinuing certain customers in central Europe in order to focus with those that we want to

build longer-term business. So there are several mix effect, but the price impact has been the biggest one.

Mika Karppinen: Is there any change in rim sizes?

Jukka Moisio: The rim size has been naturally also positive. I forgot to mention that one.

Mika Karppinen: Okay, good. Thank you very much.

Operator: We will now take our next question from Akshat Kacker from JP Morgan. Please go ahead.

Akshat Kacker: Thank you. Good afternoon. Akshat from JP Morgan. Three questions from my side, please. The first one on your full year guidance, clearly a lot to do in the second half versus what you have delivered in the first half. Could you just talk about a few drivers behind the improving underlying business profitability as you look into the second half? I know that there are offtake agreements that we kick in in the second half, but other than that, we see some negative momentum in heavy tyres, and the profitability on passenger cars is still break even. So could you just talk about some more elements that will help improving profitability in the second half?

The second question is kind of linked and on the passenger car business. When do you expect the two plants in Dayton and Nokia to hit peak or optimal profitability or the profitability that you have assumed in your midterm targets? Is it probably in the second half of 2024?

And the last question is on the pricing and inventory situation. Just overall in terms of your markets in Europe and in North America, what are you seeing in terms of pricing trends, not just Nokian, but also competitors? And if you could just talk about [inaudible] inventories as well. Thank you.

Jukka Moisio: Thank you. So about the full year guidance, so we already knew late last year, early this year that the early part of the year will be lacking volume. So you right pointed out that help will come from offtake. The other part where we get more volume is that we started a higher production or brought the higher production availability in Nokia in early part of the year. So that will be fully available in the second half. And also we keep on improving the performance in date. And so we hired additional people and we start more equipment so that will of course bring benefits.

And then finally, heavy tyres, yes, we had downtime and quite large inventories in the distribution, so on. Therefore, we took downtime extended in relation to - in connection of the summer shutdown, we expected that we are able to run relatively well in the second half and then let's see what will happen towards the end of the year and what the demand is. But we expect that the heavy tyre performance be nevertheless at 13% segment operating properly. We expect that we are there or move towards longer-term to 15%. So we don't see any more negative deviation there. But obviously it's dependent on the economic - macroeconomic in terms of what will happen in the OE demand and so on. But at this point of time we see relatively stable development.

Obviously, in the early part also, we had a number of cost items related to Russia exit and all kinds of things that are not on our way when we go forward in the second half. So this will, of course, give a more focus to our team and more capability to deliver the results. In the early part, you still remember that we got the final exit from Russia at the end of March, and then

the early part of the year included number of cost items and the focus of the team that we needed to work on that one. So we are more focused on building new Nokian Tyres with the whole team in the second half. So that will also have a benefit and also reduces the excess cost and these kind of items.

So all in all, that helps now full year guidance. But it was known upfront that the first half of the year will not deliver significant profitability, so that all of that will come with the winter tyres and the second half capability to deliver.

In Dayton and Nokia, so in isolation, we will not comment this - how they go and how they trade, but we said that the long-term ambition to have a segment operating profit at 15% will be there, and we will work step by step towards that. And you can expect that every year, every quarter, we keep on improving. So when we go to the second half of this year, you can expect that our segment operating profit zero will be higher in the second half, and also EBITDA will be higher. And then when we move into next year, we will then have a sequentially improved performance step by step. So - and that - and our ambition is then to hit that 24%, 25% EBITDA and about 15% segment operating profit.

Pricing environment, Teemu, do you want to comment the pricing environment?

Teemu Kangas-Karki: I would say that now we have reached the level where the price level has got its peak. So we don't expect that, that the prices are increasing in the coming quarters. We also then have the tough comparisons in the second half. So the price mix development doesn't continue like in the first half. And then what we see in the markets it is quite stable in terms that no price increases and not necessarily price decreases on a face value level from our competitors. But some of the competitors starting to do some promotion activities in a sense that the net real price in price changes are going down in some markets. But then in other markets, like in the Nordics, we still expect some price increase because of the currency.

Akshat Kacker: Great. Thank you for the details.

Operator: Thank you. As a reminder, to ask a question, please signal by pressing star one. We'll pause for a moment to allow you to signal. And we have a question from Pierre Quemener from Stifel. Please go ahead.

Pierre Quemener: Yes, good afternoon, everyone. Would have one question to clarify please, if I may. Do you expect a price mix to become negative at some point this year? Because the net price mix minus raw material has been very, very favourable in the first two quarters. So do you expect something to go towards neutrality or even to become negative? And if get - can have some idea regarding the phasing of the price mix into the last two quarters. That would be the first question.

And the other question I have, maybe I missed that, but have you already provided the proforma figures for the passenger tyres extra shelf for Q3 and Q4, both on revenues and on the operating profit for 2022? Thank you.

Teemu Kangas-Karki: Yeah, starting with the performance, those we delivered in the beginning of February in connection with the Q3 result release. Then go going to your third question regarding the price mix development, we don't expect that to be negative on a comparable currencies. So - but this strong momentum that we have seen several quarters is

not expected to continue in the second half because of the strong comparisons already recorded in the second half of '22.

Pierre Quemener: Okay, thanks Teemu. But that will remain a tailwind. That's not going to become a headwind, right? Even if it's much smaller tailwind.

Teemu Kangas-Karki: We are not expecting to see a headwind with compare currencies.

Pierre Quemener: Okay. That's very clear. Thank you very much.

Operator: Thank you. And as a final reminder, to ask a question, please signal by pressing star one. We'll pause for just a moment to allow you to signal. And if there are no further questions in the queue, I'd like to hand the call back over to Paivi Antola for any additional or closing remarks.

Paivi Antola: Thank you. If there are no additional questions, that means that we finish early this time. Thank you all for participating. And from Nokian Tyres, we wish you all a nice summer.

Operator: Thank you.

Paivi Antola: Thank you.

Operator: This concludes today's conference call. Thank you for your participation. Ladies and gentlemen, you may now disconnect.

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