

Transcription

Metsä Board Half year financial report January–June 2022

Mika Joukio

Good afternoon everyone, and welcome to the presentation of Metsä Board's half-year results for 2022.

My name is **Mika Joukio**. I am the CEO of Metsä Board. With me are CFO **Henri Sederholm** and Head of IR **Kati Sundström**.

I will first go through the presentation with Henri, and we will then open the lines for further questions and discussion.

Let's begin by taking an overview of the second quarter

The paperboard market's strong momentum continued, and demand exceeded supply in our main market areas. Our delivery volumes were at the same level as in Q1 but were lower than the corresponding period last year. This was mainly due to our own actions, as we have increased our very low inventory levels. In addition, last year's delivery volumes were exceptionally high, exceeding our production capacity.

Even though Q2 included quite a lot of maintenance, especially at the Finnish mills, production volumes were at a very high level. Production volumes hit a new record during the first half of this year, with paperboard production volumes almost 1 million tonnes, and pulp and BCTPM volumes 730,000 tonnes. An excellent performance, which is a reflection of the huge commitment and willingness of our staff to do things well in exceptional circumstances.

Sales prices for our paperboards continued to rise, pushing the top line and profitability to record levels. Our sales increased by almost one hundred million euros and operating result by 45 million euros compared to the same period last year. Return on capital employed was as high as 25 per cent.

Cost inflation continued to be rapid, especially in chemicals, logistics and energy.

Rising raw material costs and the improved prices of our end products increased our working capital, also impacting cash flow and net debt. But I will let Henri explain these issues further.

And last, but definitely not least, our achievements in sustainability were once again top class. We reached the platinum level in the EcoVadis rating. And for the first time, we scored the full 100 points in the Environment section. This achievement is a reflection of our hard work on sustainability and recognises our journey towards fossil free production and products by the end of 2030.

Now an update on Russia's attack on Ukraine.

You remember that our exposure to Russia was derived from paperboard sales, wood sourcing and the use of natural gas.

Thanks to the strong market situation, we have sold all the paperboard volumes released from Russia.

Wood supplies have operated normally despite the discontinued wood procurement from Russia in March.

Concerning energy, three out of our eight mills use natural gas in their production, which was previously supplied from Russia. Now the natural gas is supplied via the BalticConnector pipeline, and has been replaced partly with oil. In addition, we are preparing to replace some of the natural gas with LNG later this year. And the target remains that by the end of 2030b, all the energy we use will be 100% fossil free.

So, to summarise: the war in Ukraine has had impacts on us, but we have coped well so far. Naturally, our great concern is for the people affected by the war and their survival.

And now let's look at the paperboard deliveries.

As you can see from the graph, the volumes for both the first and second quarters this year were lower than the corresponding periods last year. And this difference comes from folding boxboard.

Last year, due to the very strong demand, our delivery volumes were at a record high and exceeded our production capacity. This year, we have increased our low inventories and prepared for the upcoming investment shutdown in connection with Husum's new FBB capacity. In addition, the allocation of Russian volumes to other markets was partly ongoing at the end of the review period.

The total delivery volumes in Q2 were 472,000 tonnes, and for the first half of this year, 944,000 tonnes.

And now the deliveries split by market area.

The demand for both folding boxboard and white kraftliners has remained strong in our main markets.

In the EMEA region, the released volumes from Russia slightly eased a very tight market situation. At the same time, the bottlenecks in logistics are keeping imported volumes from Asia and Latin-America lower than normal.

In the Americas, and especially in the US, demand for both folding boxboard and white kraftliners continued to be strong. Inland supply chain challenges have gradually eased, but cost levels have increased compared to corresponding period last year.

Strong demand with limited supply was reflected in average selling prices, which all continued to rise.

And before Henri goes into the financials, let's have an update on market pulp.

During the first half, the demand for long-fibre market pulp has been good in both Europe and China. Both Metsä Board's and Metsä Fibre's market pulp deliveries remained stable compared to the corresponding period.

The global pulp supply has been reduced by several factors like bottlenecks in logistics, cost inflation in energy and chemicals, and other planned and unplanned production shutdowns. This imbalance between supply and demand has kept prices high.

But now, I'll hand over to Henri to tell you more about the financials.

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Henri Sederholm

And now the explanations for our record high profitability

The main positive contributor, for both quarter-on-quarter and year-on-year comparison, was improved sales prices in paperboards.

Year-on-year, sales prices in euros have now improved by 25 per cent. In addition to paperboards, market pulp prices improved too, leading to a higher result share from Metsä Fibre.

Other positive items for both review periods were the impacts from FX, and the sales of emission allowances, which we now sell more evenly over the year.

On the negative side, the main burden came from cost inflation, which has been rapid, especially in chemicals, logistics and energy.

Logistics costs have increased due to the limited availability of transport equipment, higher fuel prices and the re-routing of paperboard volumes released from Russia.

Higher pulp costs impacted the profitability of the stand-alone paperboard business, yet the overall impact from higher pulp prices was positive for Metsä Board.

And wood prices, which have remained stable for a long time, have also risen.

In addition, higher fixed costs and decreased paperboard volumes weakened profitability.

However, as shown here, we have been able to more than offset the negative impacts from rapidly increasing costs.

The comparable return on capital employed was as high as 25 per cent in the second quarter, and 20.6 per cent during the last 12 months. Both are significantly above our target level, a minimum of 12 per cent.

Now the cash flows, which showed quite a big change in the second quarter.

Operating cash flow was negatively affected by an increase in working capital. The three main reasons for the increase were rising stock levels of paperboards, a higher inventory value due to cost inflation and higher receivables due to increased prices for finished products. We should also bear in mind that cash flow in the first quarter included the dividend of 59 million euros received from Metsä Fibre.

And despite the record high EBITDA of 545 million euros for the last 12 months, the leverage ratio returned to positive first time after the end of 2020. At the end of June, the level was at 0.2, leaving plenty of headroom for our maximum target of 2.5

Our own dividend payments were roughly 145 million euros. In addition, the dividend paid to the minority shareholder of Husum's pulp mill was roughly 11 million euros, also booked in Q2.

Net debt increased by 200 million euros and was 109 million euros at the end of the review period.

The continued strong financial position supports our investments in sustainable growth, about which Mika will tell you more. So over to you, Mika.

Mika Joukio

Thanks Henri.

So, let's get an update on our ongoing investments, starting with the Husum pulp mill renewal.

There we had a small headwind, as some of the installation works were delayed. Instead of September, we now estimate that the start-up of the new recovery boiler and turbine will take place in November this year.

We have made no changes regarding timing or investment amounts to our other major investments, which are the capacity expansions for folding boxboard in Husum and for white kraftliners in Kemi.

In May, we announced that we are exploring the alternatives to further increase our folding boxboard capacity either in Finland or Sweden. We haven't made an investment decisions about it yet, but the evaluation of options is expected to be completed by the end of this year.

For the full year 2022, we expect our investments to be around 300 million euros, which includes annual maintenance capex of 50–60 million euros.

And now the outlook.

We see the solid demand for sustainable paperboards in both Europe and North America continuing.

We expect our delivery volumes in the third quarter to remain stable and average sales prices for both folding boxboard and white kraftliners to increase. Foreign exchange, and especially the strong US dollar, will improve profitability further.

Demand for long-fibre market pulp is expected to remain good in Europe and China. At the same time, the supply is restricted by various factors, including bottlenecks in logistics and production shutdowns.

Cost inflation will continue, especially in chemicals and energy. Global challenges in the availability of transport equipment remain, keep logistics costs high. Rising wood prices together with higher harvesting and logistics costs, we expect the total wood costs to increase in the second half compared to the first half.

The current operating environment includes uncertainties. The stronger than expected slowdown in economic growth and weakening consumer purchasing power might also have a negative impact on our products. In addition, the energy situation throughout Europe is facing major challenges, and we need to prepare for shortages of energy supplies and high energy prices next winter. The good news is that after the OL3 is in full production, and Husum's new recovery boiler has started, our electricity self-sufficiency will increase to 85 per cent.

And based on these assumptions, we expect our comparable operating result in the third quarter to remain at the same level as in Q2.

And to summarise:

Once again, the performance in the quarter and in the first half of the year was excellent. We achieved several new records in production, sales and profitability.

Our successful price increases in paperboards and favourable market pulp development have more than offset the rapid cost inflation.

High cost inflation and rising interest rates will inevitably weaken consumers' purchasing power, which may have negative impacts on the demand for our products. This is despite the fact that most of our paperboards' end use is in everyday essentials such as food and healthcare products. In addition, the Russian war in Ukraine increases uncertainty globally. One of the biggest challenges in Europe is to secure energy supplies in the near future.

However, in the long run, megatrends such as plastic replacement and the growth of e-commerce will continue to support demand for our products. We want to meet this growing demand and are now exploring options to increase our paperboard capacity in Finland or Sweden.

And with that, we end our presentation and are now ready for your questions. Thank you very much.

Q&A

Operator

Thank you. And if you do wish to ask a question, please press 01 on your telephone keypad now. Our first question comes from the line of Robin Santavirta from Carnegie. Please go ahead.

Robin Santavirta

Thank you very much, and good afternoon, everybody. My first question is related to the current demand situation. You have had a really strong first half of the year. I was wondering if you could share some thoughts on the current order intake versus, for example, in the winter or in the spring. Is it still across the board for you guys, the Metsä Board part as strong as it was or is it a bit weaker? I guess it kind of becomes stronger than it was in the winter. So that's my first question. Thanks.

Mika Joukio

Okay. So Mika here. Demand, or the order inflow, has been good. But to be honest, the kind of panic behaviour that we saw among customers late last year and then also wintertime, that we don't see at the moment. But what is kind of interesting and true is that customers very eagerly would like to discuss 2023 already now even before summer holidays. And that is not normal. So order inflow as well as the demand has continued to be good, and our expectation is that that will be the case also in Q3.

Robin Santavirta

All right, thanks. That is clear. Then related to energy, if I understand it correctly, some 13% of your costs in 2021 was related to energy. Now, energy prices, power prices have increased quite significantly in Finland as well, and in Sweden. How is that energy consumption hedged and how will sort of the current exceptionally high prices be visible in your P&L when it comes to next year? So a bit more sort of colour on that would be appreciated. And another question related to energy. What happens if there is a gas allocation situation in Europe to the three mills that use gas and perhaps to your suppliers and to your customers as well? So those on energy.

Mika Joukio

Okay. If I take firstly your latter question. So what would happen if there is no natural gas for everybody? Of course, it's very difficult to estimate at this point. As I said, we are preparing ourselves to use the LNG as well as oil is another option. But as I said, of course, the crystal ball is not very clear as far as that kind of situation is concerned, naturally.

But then concerning these energy prices and hedging, then Henri will take that.

Henri Sederholm

Okay. Yeah. So if you look at the total energy cost, we have to remember that we have these shareholdings in PVOs, so the nuclear power plants as well as then we have of course the integration due to our ownership in Metsä Fibre. So if you look at the total energy costs, about one third of the costs are sort of market exposed. So that's kind of giving the magnitude that we need to hedge. And out of that, then we are talking about electricity where we have a high self-sufficiency after the Olkiluoto 3 starts and then the Husum boiler and turbine will start. So we have about 85% of self-sufficiency. We are hedging natural gas and other fuels. So that's the kind of part that we are hedging.

Robin Santavirta

I understand. Thank you. And the final question related to pulpwood. You have managed very well now despite of the border shut between Finland and Russia. What is the outlook – because you say higher pulpwood cost in Asia, so I guess that is quite natural. But could you share any view of magnitudes or sort of momentum? We have increased quite clearly now into the summer as normal. Should we expect continued increases from the current prices of pulpwood in Finland and Sweden? And is there any sort of fear of availability when it comes to Finland or Sweden, when it comes to your production now in H2?

Mika Joukio

So first of all, concerning availability, of course, we have had some challenges concerning the birch, but they have been solved and we don't see any major problem concerning availability. As far as the prices are concerned, of course, the stumpage prices they have slightly increased comparing, let's say, first half of last year to the first half of this year. But then we need to calculate also then all these logistic costs into this because they play an important role in wood cost at the mill, but the magnitude of the inflation in wood prices is not the same level as in energy or logistics or chemicals.

Robin Santavirta

I understand. Thank you very much.

Operator

And the next question comes from the line of Linus Larsson from SEB. Please go ahead.

Linus Larsson

Thank you very much, and a good day to everyone. Maybe if I may continue on the wood supply topic. What I'm curious about is how much is already reflected in terms of additional cost for rerouting and new sourcing and additional list price increases. How much of that is reflected in the second quarter? I noticed that it doesn't seem to be much of – it's not the key element of cost inflation that you highlight for the third quarter, it seems to me. Is that because there is a delay, that we will see wood sourcing costs come through more clearly later on, or what you know at this stage is largely reflected in the second quarter already?

Mika Joukio

If I start and then maybe Henri can continue. But the delay in wood cost or wood price is typically three to six months. So when you are able to see the new prices. And concerning then Q3 or second half of this year, we estimate that the wood prices or wood costs will be slightly higher than first half of this year, but not as much as we can see, for example, in energy, logistics or chemicals. But do you want to, Henri, add something?

Henri Sederholm

No. I think perhaps on the availability of wood that we can confirm that there hasn't been problems in the availability so far.

Linus Larsson

And those 9% that you sourced in Russia last year, what's the current situation? If you were to roughly describe which countries those volumes are coming from currently, what would you say?

Mika Joukio

That's easy. It's coming from Finland or Sweden. So we not increased our wood supply dramatically, for example, from Baltic countries. So the increase is coming from Finland and Sweden.

Linus Larsson

Perfect. Thank you very much. That's clear. And then I don't know how and if you want to answer this, but you say that the paperboard prices will be high in the third compared to the second quarter. You also say that variable costs will be higher Q3 on Q2. Is the one factor higher than the other? And if so, which?

Mika Joukio

I can only say that we are able to quite nicely offset the coming inflation in chemicals or other elements with our price increases or new prices. We have had price increase announcements and our estimation is that we are able to see those increased prices in Q3.

Linus Larsson

That sounds reassuring. Then just one final question, if I may, on your dividend policy. It says that you are supposed to pay out at least 50% of EPS. Is there any way we could misunderstand that? I mean, is that valid any given year? You have a strong balance sheet; market seems strong as it appears. Should one view it over a business cycle, anything like that or is there any way of misunderstanding that message?

Mika Joukio

No, no. I think the message is very, very clear. That is precisely our dividend policy. And that is not kind of connected to any kind of years or whatever other topics or issues. So that's quite a clear statement, or very clear statement.

Linus Larsson

It's valid for in this case, the reporting year 2022?

Mika Joukio

No reason to believe something else at this point.

Linus Larsson

Fantastic. Those were my questions. Thank you very much.

Operator

The next question comes from the line of Johannes Grunselius from DNB Markets. Please go ahead.

Johannes Grunselius

Yes, hello. Johannes Grunselius here. My first question is on the higher production versus shipments, and you obviously build quite a big, took up the net working capital in the second quarter. I was wondering if you could help us in providing some insights how this was impacting the P&L, and also the net working capital, do you expect that to be released extra value on the net working capital side in the third quarter? Thanks.

Mika Joukio

Yeah. Okay. This inventory increase, especially in folding boxboard, not that much on white kraftliners, but in folding boxboard, that is coming from the fact that our inventory levels were very, very low in the beginning of this year, also after the Q1. And we needed to increase that, and also then the other reason is that we are preparing ourselves to this Husum investment next year. So in order to serve the customers during that shutdown period, we need to have higher stocks. And that is the other reason.

But as far as the net working capital and other things you asked, Henri can comment.

Henri Sederholm

Yeah. So the inventory levels are back to the normal level, and we don't have any plans to increase them any further. It's also good to note maybe two things about the net working capital increase. Firstly, the cost inflation is obviously reflected

in the value of the inventory. So the increase in the inventory is based on not only the amount but also the value of the end products, and then then the receivables obviously reflecting the much higher price levels.

Johannes Grunselius

Okay. That was clear, but if we then look at the third and the fourth quarter, should we expect any increase in the folding boxboard shipments compared to Q2? Was it sort of a bit lower than what is representative going forward?

Mika Joukio

So typically, then Q4 volumes are lower than Q3 volumes because of the seasonality. It's too early to kind of comment more detail, but that is very often the case.

Johannes Grunselius

Okay. A bit back on the pricing. There was a few questions on that already, but could you just indicate what kind of overall price increases we are talking about in the third versus the second quarter? Is it sort of small percentage or is it more meaningful?

Mika Joukio

No, it's smaller. If you compare the first half of this year to last year, our prices are 25% higher. Of course, we are not able to see that kind of increase in Q3 comparing Q2, but some minor increases, yes.

Johannes Grunselius

Okay. Then final question from me. If you compare the US market now compared to the European market, are you seeing similar strength in the market or any other market developing better than the other one in relative terms? Can you sort of elaborate a little bit on that?

Mika Joukio

Yeah. Both markets have been strong for us. Of course, the kind of extra challenge has been in the Russian case that we have reallocated the volumes from Russia elsewhere, mainly here in Europe. And that has been able to do without any major problems. So that shows that demand has been good. So I would say that the US market, as well as the European market, both have been strong. And the estimation is that that will be the case also in Q3.

Johannes Grunselius

Okay. All right. I also wanted to take the opportunity just to ask you how you read the new behaviour that clients want to talk 2023 shipments already at this stage. I mean is it more to position themselves or are we talking about that you are securing business already now in the summer period or how should we look at that? If that's more an indication of a sort of healthy market next year? Or is it impacting your business in a more tangible way?

Mika Joukio

We have not been active here. The customers have been active to start discussion concerning next year. But I think there are two elements. First of all, last year, maybe the customers have learned that, that the earlier you start discussions, the more secure are your volumes next year, and then also customers see that this good situation will continue. It's good to remember that kind of the lion's share of our products are used in end uses like food or pharmaceuticals and the consumption of those are quite stable.

Johannes Grunselius

Yes. Okay. Understood. Thank you very much. Very helpful answers.

Operator

And the next question comes from the line of Harri Taittonen from Nordea. Please go ahead.

Harri Taittonen

Yes. Hello. Good afternoon. Just reading in the report that you're saying about this reactivation of some substitution projects and that could give some sort of boost for demand, which has not been the case earlier. But, is it sort of any particular end use or type of products that you could specify or kind of give some colour on where this kind of substitution could pick up pace?

Mika Joukio

It's very easy to answer. It's mainly the food segment. Not only, but mainly.

Harri Taittonen

Okay. Good. And then while this has hardly been talked about already in several ways, but if you think of the cost base and sort of sequential development, Q2 versus Q1, and if you then look at Q3 versus Q2, is it sort of a similar sort of pace of cost increase or is it sort of when you put all these individual items together, what's the kind of overall picture of the shape of the cost inflation?

Henri Sederholm

Yeah, this is very difficult to predict, as we have seen over the last quarters due to very rapid changes in the energy prices, for instance. Some of the cost elements are more stable, like the logistics costs, where we have longer agreements where we can see that. But otherwise, it's really difficult to say. We are, I guess it's fair to say that we are not expecting an increase in the base, but there is clearly some stabilisation and it's too early to really confirm that either. So we'll just have to see.

Harri Taittonen

Yeah. Okay. Thank you very much.

Operator

And we have one more question from the line of James Twyman from Prescient. Please go ahead.

James Twyman

Yes. Thank you very much. So I was just wanting to know how much of the European market would you say for white top kraftliner, and boxboard was coming from Russia, and have you noticed a significant benefit from that as well as the negative impact on your exports there?

Mika Joukio

Yeah. So our sales to Russia last year was roughly 130,000 tonnes and that was only folding boxboard. We didn't sell what kraftliners that much. If you think about the production in Russia, there is practically only one folding boxboard mill having capacity of 200,000 tonnes. So that is quite minor player in this battlefield.

James Twyman

And in white top kraftliners? I think there's quite a bit of production from Russia as well, isn't there?

Mika Joukio

I don't have the exact figures in my mind. We can revert to that later, if you like.

James Twyman

Okay. But you haven't noticed a significant impact on the European market from Russia effectively?

Mika Joukio

We are selling mainly coated grades. I think they don't have that grade. And also, then virgin fibre or fresh-fibre linerboards, kraftliners.

James Twyman

Okay. Thank you very much. And in terms of white top kraftliner, do you expect those prices to be going up in Q3 as well as boxboard?

Mika Joukio

More on the on the folding boxboard side.

James Twyman

Thank you very much indeed.

Operator

And there are no further questions.