

Webcast transcript: Interim report 1-9/2021

Time 29/10/2021

PRESENTATION

Tommi Järvenpää

Good morning, and welcome to YIT's Third Quarter Earnings Webcast. My name is Tommi Järvenpää, I'm the head of YIT's Investor Relations. We will be discussing today how our good profitability progress continued in the third quarter. The results will be presented by our CEO, Markku Moilanen, and the CFO, Ilkka Salonen. After the presentation, we will be taking questions from the conference lines. At this point I would like to hand over to Markku. Please go ahead.

Markku Moilanen

Thank you, Tommi. And good morning and welcome on my behalf as well.

We'll start as always from health and safety, which is, as we have said, number one in our priorities. Unfortunately, I have to start today by telling that during the third quarter, we have had two fatal accidents, one in Latvia and one in Lithuania. We have, of course, analyzed the cases thoroughly, have done an action plan, and are implementing the actions, reviewing and adjusting our processes and practices to prevent these kind of accidents to happen in the future. As we are doing in every occasion in our organization when we have been informing about these cases, we have had a silent moment for a while. So let's have it even in this case.

This year in health and safety, our measures have been quite much around fighting against the COVID-19 pandemic. And now, during the third quarter, the situation in all those countries that we are working is getting to a better direction, thanks to the vaccinations. But we have continued our actions to make sure that our personnel, both on sites and offices, can continue working in a healthy environment, and the results have been good. If we are looking at our combined lost time injury frequency, which is our key KPI on this area, that is still on a too high level for us. We are targeting to get it below 9 and, during Q3, the rolling KPI was 9.8. What we have done is that we have started a rigorous plan and – starting from management works in the sites, we have started that from the management teams. I've been in several sites myself and all of the directors are doing the same as well. That has led to a higher-than-ever number of safety observations and fixing things, but a good observation. So, we are in a process to change and improve our health and safety culture with these actions.

If we are looking then, the results during Q3, so we had a good profitability progress. So, this is the third quarter in order where we have a good result, and our group adjusted operating profit ended up to be €18 million compared to €16 million last year. More importantly, our January-September results more than doubled. Our adjusted operating profit more than doubled compared to last year during January-September to €69 million. The result was a result from our solid performance in our housing segments where we have improved margins all over, but a favorable sales mix as well. So, we have sold higher priced apartments, especially in the CEE countries. In addition, we have been able to shorten our lead time, so earlier project completions have led to higher results on that area. Our hard work in improving our profitability and performance in Business premises continued. We were having black numbers and positive numbers, but the underlying work is really a question of cleaning up the old projects and even with all that work we ended up to a positive result. And the same happened in Infra. We have started the turnaround or the transition to a new mode in Infra about a year later than in Business premises, but the work has continued very well. And we had the underlying operating result was very good. So, despite of the margin reduction in certain old projects, our Infra result during Q3 remained positive.

Our – the key things that we have done during this year have been focused on improving our project management. We have looked at our operational model and there we have had the work to make our new strategy. On project management, the work has continued that -- to remind you, we started the work end of 2020 actually, and we have launched new processes, practices, systems, reports, training for personnel, controls. And again, you can see the results already paying off in Business premises and in Infrastructure segments. Secondly, we started last spring our operating model work, and the target was to create a more customer-oriented, closer to the customer operating model, and a more efficient model as well. And we have concluded that work and the related statutory negotiations we have ended as well during Q3 as we have earlier communicated. So, the result is that we will reduce maximum 230 employees in the whole Group globally, of which 190 employees in Finland. Out of these 190, approximately 110 will be achieved through redundancies and the rest 80 through voluntary departures, terminations, retirements and fixed-term employment endings. We will start the new operating model from 1st of January as part of our strategy as well as so now we are in a process to implement the needed changes. So we are coming back to the model when we tell about the new strategy. The strategy work has progressed very well as well and we are ready to tell about our new strategy then before our Capital Markets Day, which is on the 23rd of November. And let's go a bit more in detail in Q3 results. So, Ilkka, please, the floor is yours.

Ilkka Salonen

Thank you, and good morning, everyone. Yes, if we look at the from the revenue side starting from that part, that was roughly about €100 million lower than last year. And there are the two major topics over there. One is related for Infra roughly about €70 million lower and that is pretty much driven by the fact that we have been more selective in projects when we are tendering. Also as we sold our Estonian operations in Infra, there is lower volumes in the Baltic countries. And then the large projects are, a couple of large projects, are in their final stage, so it means less revenue from there. From the order book, increasing quarter-by-quarter this year and also it is higher than the Q3 last year. And the growth is seen in the right places. Meaning that Housing Finland and CEE, Business premises and Partnership properties. Where we see decreasing order book is in Russia as well as Infra. And there are explanations for those ones as well. And as I mentioned earlier, we have been more selective in tendering of projects and also in some alliances, we are in the design phase at the moment. So, the amount of the projects in millions is very small compared to the full project. And then in Russia, actually two topics, well, as we have announced earlier that we are leaving from some areas and that is progressing. So it means that there is less operations in those areas and also in Q3 we didn't have any start-ups in our Russian operations.

In the adjusted operating profit side, €18 million compared to the last year €16 million. If we look at the year-to-date figures, they are €69 million compared to €29 million. So the track has been improving this year. And what is also good to mention is that all the segments, all the business lines were delivering positive adjusted operating profit for third quarter.

And if we look at the deviations compared to the last year and for this year in Housing Finland and Housing Russia, solid performance over there, although there were lower number of completions in Finland than last year. In Business premises, there we see operational performance stabilizing. And in the Infrastructure, yes, we have made some margin reductions in certain old projects, so it has a negative impact over, the Partnership properties, more or less for the quarter cyclicity. And then in others, there is somehow more eliminations than last year, and we end up to €18 million over there.

Operating cash flow minus €23 million, last year minus €9 million, so pretty much on the same level than last year, even our start-ups during this Q3 was higher than last year. And if we look at for the first nine months operating cash flow, we have generated more than €160 million on that side. And investments for the plots as well as for the associated companies, has continued also in Q3 this year.

And then net interest-bearing debt, as we mentioned, in Q2 that we are boosting the start-ups, it can be seen over here, as well as in the capital employed side. And then in the maturity structure of interest-bearing debt that has been restructured quite heavily during this year, as you remember in the beginning of the year we had two bonds and hybrid bond over there, and we have also renegotiated our bilateral loans, a number of those was during this year.

And then to the metrics, equity ratio as well as gearing, both of those have improved during the last one year. And then the debt to adjusted EBITDA ratio as well as interest cover ratio, are also reflecting about our performance. And now I pass back to Markku, please.

Markku Moilanen

Thank you, Ilkka. Then let's go to the market outlook. All in all, the Q4 market outlook is very stable, very similar than before. So, in the housing markets, no changes, they remained on a good level. On real estate market, the only change is that the Finnish real estate market is improving, especially on the private side and on the investor side, which is of course, hopefully, I can say, after the COVID-19 or in this phase is showing that the market is getting better on that area. On the infrastructure market, the weak Baltic market continues, that's the only notable change in that area.

The big question in the construction industry has been the material cost inflation, which is on place as you can see, and as you well know, that the cost indexes, the cost have been increasing especially in timber and steel structures. And we have our mitigations on place. So, we have had procurement practices using indexing, using our purchasing power as a large customer to the provider's long-term contracts as well. And then, pricing and contractual practices, like our dynamic pricing in Russia and in the CEE countries in housing as well. So, what it comes to our forecast for 2020 is that we see that this material cost inflation will not have a material impact to our resource as it hasn't had so far. This assumption is based on our knowledge and understanding on the market that the material cost inflation will level-off. However, it's good to realize that if the cost inflation continues, then it will certainly have an impact to both to YIT and the whole construction industry as well. But clearly, it is our aim to move these costs to the end user, material cost increases to the end user prices and therefore mitigate the impact to the company.

If we are looking at the number of apartment completions that we had on a low level, as you can see from this slide during Q3, so they are now, they're expected to peak during Q4 in Finland and in the CEE countries, so we are really taking off and again, the same will be next year as well. So, we'll have a very high peak of completions during Q4 in 2022. Then on this picture on the green circle, it's good to remember that these are our own development and our own development projects. In addition, we have apartments under construction for investors in Finland and the CEE for more than 2,000 apartments, and then more than 4,000 apartments in Russia as well, so just to explain the kind of differences between the different quarters and again good expectations for Q4 in that area.

So our guidance for this year, 2021, remains the same, so that we expect our group adjusted operating profit to be higher than the last year. And again, the impact in housing in Finland and CEE will come from the high level of completions that we are expecting. In Housing Russia, we expect the solid underlying performance to continue as well as it has been throughout the year. In Business premises, we expect to stabilize further the business. And actually, as we have these old projects that we are finalizing and doing the final fixes, it is our expectations that we are able to close those projects during this year. So, that is our expectation in Business premises. And, again, in Infrastructure, like I mentioned earlier, our review and the turnaround on the segment started about one year later. The impact of certain low-performing projects will have an impact on our result this year and continue for a while next year as well. Again, I want to highlight that we have a very solid good underlying healthy business, especially in Finland which we saw during Q3 that the overall result was positive despite of the certain old, low-performing projects. In Partnership properties, the portfolio development is expected to continue. And of course, our position in the Mall of Tripla valuation has an impact to the result of the Partnership properties. And again, looking at the number of visitors in Mall of Tripla, it is clearly increasing as the pandemic restrictions ease. So it hasn't had yet an impact on YIT's result, but if it have it will only – we expect it only to be positive.

To summarize, our management agenda for the second half of this year, as we have communicated before. So we continue the actions to stabilize our performance. We have now three consequent quarters with a stable performance and I'm very proud of our organization, both in those areas that we have high-performance, but on those ones where we have challenges and we are doing all the needed fixing. We will implement our new operating model. So as I told, we have finalized the work, we have concluded the statutory negotiations and we'll do all the implementation so that we have a new operating model and organization on place from the 1st of January next year. We are in a process to finalize doing the last steps of our new strategy, which will be launched then prior to the Capital Market Day that will be on the 23rd of

November as well. And again, last but definitely not the least, we'll take proactive actions in health and safety to improve further our culture in health and safety. And as part of the new strategy, we are developing our sustainability roadmap and again, we are coming, as part of the strategy, going to tell that a bit more during the launch of the strategy.

So, as I've mentioned a couple of days, so we have our Capital Market Day on the 23rd of November and we'll have a webcast in the afternoon starting from 1 o'clock, PM. So you're all welcome to join that, or Tommi can tell a bit more if you want, about the Capital Markets Day.

Tommi Järvenpää

Yes, indeed. So, Capital Markets Day will be hosted on the 23rd of November and then the webcast information will be available on the website closer to the event. But at this point, I think we are now ready for the questions. So, operator, please go ahead.

QUESTION AND ANSWER SECTION

Operator

Thank you. Our first question comes from Anssi Kiviniemi with SEB. Please go ahead.

Anssi Kiviniemi

Hi, guys. It's Anssi from SEB. Thanks for taking my questions. I have essentially three themes, and I will take them one by one. First of all, starting with the Housing business, when we look at the Q3 result, was it better than you expected, meaning that the completions for Q3, were those higher than you originally assumed? And on underlying profitability, was the performance better? What should we think about the kind of relative strong figures on a seasonally very, very low quarter?

Markku Moilanen

Yes, thank you. Yes, they were better than we expected. So – and it was both on the earlier completions, but it was the favorable mix as well and the sales prices as we have dynamic pricing, pricing in CEE countries and in Russia as well as. So we were – that was a positive result compared to the expectations.

Anssi Kiviniemi

Okay. Thanks. And when we look at the mix and when we look at the kind of your pricing assumptions going forward, should we expect the good performance also continue or is there something kind of one-off type of element in the Q3 result in – especially in Housing Finland and CEE?

Markku Moilanen

No, there is nothing, nothing one-off. So, if we're looking at the pipeline and the completions that we're expecting, actually last year, we had a kind of one off a bit of investor sale which was a bit lower than before, if you compare that to last year's result. But the similar level of performance is expected to continue in Finland and CEE and in Russia.

Anssi Kiviniemi

Okay. Thanks. Then on Infra, you highlighted that there were project margin reductions, could you elaborate a little bit more on how much it impacted Q3 result? Are we talking about couple of million, so are we talking about €10 million or kind of what's the roughly the magnitude of the impact?

Markku Moilanen

Well, we are not opening the details, But I would say that we really had a strong underlying performance, which is telling that again, the healthy core is producing good profit. But we're not opening the details on those.

Anssi Kiviniemi

Okay, thanks. Then on construction inflation, I appreciate that you kind of indicated there will not be any larger impacts in 2021. But what should we think about 2022? I understand that there is an expectation, so perhaps the inflation levelling off. But if we would assume that the inflation of prices course remain at the

current level, what is the magnitude of the impact for your result? Are we talking about single millions or are we talking about double digit figures? Anything, any indication would be very, very helpful, I think for all of us.

Markku Moilanen

Well, again, if they remain on the current level and looking at our project portfolio where we have a significant amount of projects in our self-developed project where we can impact on the pricing as well, so we can move that today and use the pricing. Then it's new projects in new contracts, well, we will do the same as well. So if it's not increasing – if it would be increasing, if I start from that, then I would expect the demand to go down both in apartment and in housing but in construction project as well. So, it's immature to calculate the impact next year. Of course we are doing the planning based on the current level when we are talking about our targets and budget for this year. But again, based on our experience this year, we have been able to mitigate it and the tools are on place again for next year. So it's premature to open any numbers at this stage.

Anssi Kiviniemi

Okay. That's all for me. Thank you, very much.

Operator

The next question comes from Simen Mortensen with DNB Markets. Please go ahead.

Simen Mortensen

Thank you, for taking my questions, guys. I had had three of the same questions actually, but I have a few other ones as well. When I look into the housing data, in Finland, I see the plot reserves Q-on-Q have fallen 18% in terms of number of square meters in the plot reserve, could you please elaborate a bit on that? Is that – it was a huge deviation Q-on-Q, I just wondered what it was.

Tommi Järvenpää

If I can – I can comment on that one. So actually, there was a change in the calculation method. We basically changed the way how we calculate the plot reserve in Finland to match the group-wide way to do it. So thereby it's a sort of mathematical way. But before that plot reserve number used to include those plots which were sort of in the development phase. And I'm not sort of in a hard figure, but now it's matching that, the group-wide way of doing it. So it's a mathematical thing.

Simen Mortensen

Okay. Just regards that – another thing is building cost inflation. We have all those seen in timber, we have seen it in steel, in concrete in the rest of the Nordics have seen issues also there, in Sweden we have, I don't know how you're familiar with Cementa, which has lost its operating license in Sweden. There's the risk of rationing cement in Norway and Norcem. Also Heidelberg has stated price increases of 25% to 30% for cement from 2022. How are you seeing cement prices developing in the markets you're active in? Because what we see in the rest of the Nordics is that the price of cement is significantly escalating as well. Inflation in those haven't been that much yet in the markets, but what are you seeing? Is that also a risk and how do you mitigate the risk and supply on cement going forward?

Markku Moilanen

Yeah. If we're looking at the concrete elements prices in the markets we are active and using them, we – which is majority in Finland, but of course, Russia and CEE, there has been some increase but not significant on that area. It is more the question of high availability like precast concrete structures where we are again a big buyer and we have large framework contracts and we have been able to use that for our benefit. So, the only thing that I would highlight is there – the challenges regarding cement are in Sweden which some of you might know and their challenges have been discussed with our organization in Sweden, as well as the concrete providers in Sweden. And the Swedes are still positive that they will solve this challenge that they have created in the country. But if they – if something would happen to cement, so then of course the availability of cement and concrete would be seen also in the surrounding countries.

Simen Mortensen

I mean – just in terms of the cost inflation we have seen so far, just to try to – we talk about starting to separate when you do construction for a third-party and in terms of when you do your own developments in Housing, for instance. How much, for instance, do you expect price per square meter to go up based on the building inflation we have seen so far for producing housing units, for instance, in Finland? And how will that eventually impact profitability in future margins for development in Finland as you can see? So, please, first, the effects of the rising cost in terms of price or cost per square meter of the residential development? And how do you see that one impacting your margins eventually in housing or potentially?

Markku Moilanen

Well, firstly, the – as the housing market is good and our plot reserve is in a good places, there is an overall price increases of price per square meter as well. And again, therefore this is a combination of overall kind of price increases and impact on the materials as well. So, it's not something that we will open as part. But, of course, it is our target to keep the same profitability moving forward than before.

Simen Mortensen

Yeah. But you don't want to say how much, this inflation we have seen so far will mean in terms of the building costs...

Markku Moilanen

No, we have no... But the key thing is the profitability levels that we are targeting.

Simen Mortensen

Thank you. And then, in terms of the CMD, are you willing to give out a bit of a highlight of what you're revising to financial targets, geographies, segments, or could you give us something to go on? I'm just wondering if you have any small ideas of what you – will you give us a small leak of what you're planning to say?

Markku Moilanen

I know. I know it. It would be tempting from my side because you can guess that we have done – we are quite far in the strategy work. And then, we are finalizing the story. But, of course, you have to wait for the Capital Market Days to – for the story, story. And so, even, it's only a few weeks.

Simen Mortensen

Yeah. And I had – and I had to ask – and I know I had to ask. Thank you.

Markku Moilanen

Thank you.

Operator

Our next question comes from Olli Koponen with Inderes. Please go ahead.

Olli Koponen

Yes. Hello. It's Olli Koponen from Inderes. I have a few questions left. First, on the Housing Russia, there were zero housing starts in the quarter. Is there any kind of specific reason for this or was this just kind of a normal fluctuations in the starts?

Markku Moilanen

Yes. We have this year evaluated our risk position in all the geographies and wanted to reduce our risks in Russia and that, therefore, we are overall aiming for lower volumes in Russia to move forward. We have a strong plot reserve and a good project pipeline. We have over 4,000 apartments under construction. So this is – the Q3 was just a question of kind of difference between quarters. But the overall level we are planning to take a bit down to reduce our risks.

Olli Koponen

Is there any kind of area where you see more risk than other area?

Markku Moilanen

No. It's the overall market structure and the model of using the escrow accounts and all of that where we just wanted to take the risk a bit down.

Olli Koponen

Okay. Fair enough. And one more question just to clarify, on the Infra segment, in the start of this year, you informed about the sale of the wind park in Lestijärvi. You said that it would close – the deal would close during 2022. Any new info on that, when the deal is going to close?

Markku Moilanen

The situation is still the same. So we expect it to be closed during this year and the impact, as you well know, will be around €40 million. Again, if it wouldn't, that would be the biggest swing effect for our result. But so far, the project is progressing well, so the expectation from our side is still the same that we would close it during this year.

Olli Koponen

Okay. I think that's all for me. Thanks.

Markku Moilanen

Thank you.

Operator

Our next question comes from Svante Krokfors with Nordea. Please go ahead.

Svante Krokfors

Yes. Good morning. Svante from Nordea. I have one question left regarding, you explicitly mentioned in the Q4 market outlook slide that the real estate market, investor market is picking up in Finland. Should we have a positive read for your large co-ownership projects development on that comment? Is the investor interest increasing also from your perspective on future projects or are investors still on the sidelines?

Markku Moilanen

Yeah. You are reading it right. So, both in the several smaller ones that we have ongoing, but some of the bigger ones that we have on our pipeline are progressing – have been progressing well during Q3.

Svante Krokfors

Okay. Thank you. That's all for me.

Markku Moilanen

Thank you.

Operator

We have a follow-up question from Anssi Kiviniemi with SEB. Please go ahead.

Anssi Kiviniemi

Yeah. Hi, guys. It's Anssi once again. I have a follow-up on Olli's question on Russia and your answer. I mean, your comment was that you're aiming to take the risk a little bit down, but kind of starting zero apartment, it's more little. Is there something happening in the market that perhaps you see – that you see that there's a real potential risk of something happening. So, kind of, is there a real reason behind this move or kind of how should we read the situation?

Markku Moilanen

No. There's nothing in the market. The market remains good, good that nothing happening in that sense. It is the question of, as I mentioned, the model in the market where we have a significant amount of money in the escrow accounts. And again, we want to take that down a bit. So, it's a more general issue de-risking in our position in Russia.

Ilkka Salonen

Yeah. And if I give an example, is that in the – before the escrow accounts became compulsory; actually, we were able to collect all the money from the customers as a prepayment. Now, the prepayments are going to the escrow accounts. And if nothing else has changed the amount of money which is at the moment in the escrow account is €100 million. So, compared to the old world we have €100 million more debt compared to the old life as well as the capital employed. So, that's the reason why we are decreasing the risk.

Anssi Kiviniemi

Okay. And has the Russian ruble move any way affected the decision? And a follow-up question on that, has the Russian ruble move impacted the market in Russia in any way?

Markku Moilanen

No. That has had no reason for us to do this. And again, for the demand there, it has had no impact in the market.

Anssi Kiviniemi

Okay. That's all for me. Thank you.

Operator

There are no further questions. I'll hand back over to our speakers.

Tommi Järvenpää

Thank you very much and thank you everyone for the active discussions. Again, I would like to remind that our CMD will be organized on November 23. Thank you and goodbye.