

Webcast transcript: Interim report 1-3/2022

Time 29/04/2022

PRESENTATION

Tommi Järvenpää

Good morning and welcome to YIT's Q1 2022 Results Webcast. My name is Tommi Järvenpää, I'm the Head of YIT's Investor Relations. We had a good start for the year. Q1 was solid, driven especially by strong performance in housing. Today, we will be discussing how our profitability developed and how our businesses are performing. The results will be presented by our CEO, Markku Moilanen; and CFO, Tuomas Mäkipeska. After the presentation, we will be taking questions from the conference call line. And at this point, I would like to hand over to Markku. Please go ahead.

Markku Moilanen

Thank you, Tommi. And good morning and welcome to the webcast on my behalf as well. So, let's have a look at our Q1. And overall, we had a solid quarter. I have to say that I'm very satisfied on our performance and our progress according to our strategy as well. We have our new focused strategy. We were able to utilize our capabilities in all business segments successfully, which led to very good results in terms of profitability as well. In Q1, as we have announced earlier, we accelerated the strategic review of our businesses in Russia that we initiated already in November last year. And as a result, we were happy to find a solution to sell our business in Russia. The closing process is ongoing. It will take a bit longer than originally anticipated, but we expect the closing to happen during Q2 this year. The third thing really related to Q1 is that we have a strong balance sheet. And despite of our sale of the businesses in Russia, our balance sheet remains strong. Our CFO, Tuomas Mäkipeska, will open the balance sheet a bit more a bit late.

Starting from the numbers, so revenue wise, our revenue was a bit lower than during Q1 last year, and that was a result of a lower number of apartment completions as planned. So, all in all, revenue was as expected. The adjusted EBIT was very good, so that grew from €15 million to €22 million. And even more importantly, we are on way to improve our overall profitability. So, our adjusted EBIT margin grew from 2.7% to 4.2%. We had solid quarters in all segments. And this is, of course, very important for us as well. Housing was really the locomotive, again, continued their strong performance. And we had very good sales in Housing, even a bit stronger than we initially expected. Still, if we look at the first half of this year, we expect that to be along our original expectations. So, they're very high sales to normalized during Q2. Very good thing in Business Premises and Infrastructure where we have already started our actions to transform the business, they are clearly showing results. And kind of behind the scenes, it's important to understand that we had no surprises in our projects in those two segments. So that is notable showing in black numbers as well. Our new Property Development segment resulted positive numbers as well. And again, it's good to remember the business model of the property development where we'll have a kind of a relatively low level of revenue and margin in a normal situation. But then when the big items – when the development items either in a property or in wind power happen like we had the Lestijärvi sale during Q4 last year, then we'll, of course, see big numbers in terms of revenue and profit as well. But all in all, all the segments in black, which brings strong confidence for us moving forward.

We continue to execute our strategy, and we have the three focus areas in our strategy; focus, productivity, and ESG. Starting from focus, we continue to investment – to invest in attractive urban plots in the growing areas. Secondly, we continued our new way of selecting a project – the selectiveness of projects in tendering. And it's notable to look at our order book still. Still, even if we are more selective, we are doing rigorous risk management than we are selecting those where we have our core competencies where we can

win and we can deliver in a profitable way. We were able to keep a good order book in all segments as well. And in the big picture, our business portfolio was streamlined by the sale of the Russian operations as well. Going to productivity, we implemented 1st of January our new operating model, and we expect to have annual savings between €15 million to €20 million by 2023 compared to the baseline of 2020. We took steps forward on ESG as well. So, on the environmental area, we had our actions and development related to achieving the Science Based Targets initiative that we have committed and to reach good result in EU taxonomy as well.

And, again, to open that a bit what we have been doing, so if you think the life cycle of built environment and where we can have action and will have actions in terms of reducing our carbon footprint, firstly, it's about materials. So, we continued development and taking into use as low-carbon materials like – such as low-carbon concrete and steel. Secondly, on our construction sites, we developed and take into use fossil-free fuels whenever possible, reducing our carbon footprint over there as well. And the third part of the life cycle is, of course, the energy usage. And especially in our own housing need, we move towards our direction to reduce the carbon footprint of the energy used in our self-developed housing and real estate as well. So, we are well underway on that. I'm particularly happy with our results in work safety. So, our combined lost time injury frequency, the 12 months average, decreased from last year's 12.2 to 10.5. Yeah, that is still high, as I see, but we are moving to the right direction. And the key reason for that is, is that in our Housing segment's capital division where we have done already for a longer time decisive actions to improve our safety culture and developed our safety-related procedures. This means that we have taken regular and more and more safety walks by the managers. We have increased the level of safety observations from all level of the organization. We are faster to respond on deviations and giving feedback and sharing good practices. Those experiences, we are rolling out the same kind of actions to the other deviations as well. The next one that we did, we launched our update and training on the code of conduct. And, finally, we made an internal audit to inspect the non-EU workers in – on our sites as well. And the result was that we found only two noncompliant work permits out of the 444 inspected. Of course, we took the actions on those two as well.

Moving forward and opening a bit of the situation of our land bank because we invested on our land bank as well. So, in Kladno, close to Prague, we invested on a plot, enabling us to build 430 housing units. We invested a few plots, the most notable in Tapiola in Espoo and as well as in Järvenpää. So, all in all, our land bank enables construction of 32,000 new homes, and we are really growing the land bank in the growth areas in this picture zone on green. At the same time, we continued to structure our land bank so that divesting plots in the nonstrategic region as well.

All in all, if we are looking where we are in our trajectory, so we are well now positioned to achieve our financial targets for 2025. If we start from the EBIT profitability, our last 12 months figure is 3.5% compared to 2.8% in 2020 and 3.2% in 2021. So, we are well on our way on that. Our gearing is still behind our – below our goal, which is below 50%. It's increased from 30% to 40% due to the Russian sale as well. And again, we are well on our way to stable growth on dividends.

So, let's have a look at the finance numbers a bit more closer. So, I'll hand over to our CFO, Tuomas Mäkipeska. So, please, Tuomas.

Tuomas Mäkipeska

Yes. Thank you, Markku, and good morning on my behalf as well. I would like to echo what Markku mentioned. So, we had very solid performance – financial performance during the Q1. If we look at the most important financial KPIs describing, of course, our strategy execution and the impact of the execution, first of all, the order book was strengthened significantly. Also, as already mentioned, adjusted EBIT both in absolute and relative terms was increased significantly. And at the same time, we were able to decrease our net debt position.

But before going more into the details with the numbers, so two important topics to handle before. First of all, as we published earlier this week the financial information from 2021, so we restated the financial information because of the two components. First of all, operating model change that took place starting this year. Basically, now, going forward, we have four reportable segments and also some intra-segment changes were made according to the new operating model.

Second topic was the sale of the Russian operations. So, now going forward, it is classified as assets held for sale and reported as discontinued operations.

And this is actually the second important topic I would like to raise here is the financial impacts of the sale of the Russian businesses. First of all, as published earlier, so we made an impairment of €150 million, and this is now reported as part of the discontinued operations. And of course, this had a negative impact on the group result for the period which, including the discontinued operations, amounted to minus €130 million. We have the accumulated translation difference in our balance sheet, which amounted to €300 million, a bit above the – or below €300 million at the end of year one. And this will then be booked to the income statement when the sale of the operations is closed. And that is also reported as part of the discontinued operations. But now, going forward, with the figures and the key figures, so, first of all, on the left-hand side here, you can see the order book development. So, we are on a positive trend with our order book. We were able to increase our order book compared to the last year, and this is a clear demonstration of our competitiveness in the market. As Markku already mentioned, so we are practicing a rigorous selectiveness of the projects and tendering, what we are all participating. And in – despite of that, we are able to increase the order book. So, it's a clear demonstration of competitiveness in the market. Also, from revenue perspective, you can clearly see here that the seasonality of our business. And there is a small decline compared to the last year in our revenues, and one kind of a reason behind that is also a positive one-off in last year's Q1 sales – sorry, in revenue and also a bit lower revenues in housing in Q1, as Markku already mentioned. So, those were the main reasons behind the revenue development.

Now, maybe the most important KPI to follow, we were able to increase the adjusted EBIT both in relative and absolute terms. From group level, there were two main levers that we pulled, the first one being – related to our strategy and operating model. We were able to increase our cost efficiency due to the new operating model. And the second one is the project management excellence and which resulted a lot lower net deviations in our projects than before. So, those are the two main drivers on a group level for the improved EBIT.

If we look at it from the segment perspective, the biggest contributor is, of course, housing. We had very good sales and sales mix with the improved margins also, also, which resulted in very good operational performance in housing. And it was also supported by a couple of smaller positive one-off items. Then, if we have a look at the Business Premises and Infrastructure development, so the transformation is progressing well even though the absolute development in EBIT is not significant, but still it is a step to the right direction. Transformation is progressing well, and one key indicator there is also the net deviations in the project. As mentioned, they are a lot smaller than before. In Property Development, basically, just a small decrease in EBIT, but basically, the performance is flat there. Then, going back to the investments for growth, Markku just presented the land bank developments there. So, you can see on the left-hand side the cash flow development and the negative cash flow from Q1 is related to the investments for growth and especially the plot investments that we made during the Q1.

Also, the same thing is reflected on the right-hand side on the Q1 capital employed. So, the capital employed increased a bit from the year-end, but still decreased from last year's figures. This is related to the growth investments according to our strategy. An important topic is our debt structure here. On our – on the left-hand side, you can see the gross debt structure. And at the bottom of the stack, we have the IFRS 16 lease liabilities, and the housing company loans related to the unsold apartments, which are then passed further to the consumers when the apartments are sold. So, those are basically not conventional net interest-bearing debt in a sense. And if we exclude those from the gross debt, we would have -1 in net debt. So, that is very important structure to understand. We are basically net debt-free. Also, if we look at the portfolio, the debt portfolio on the right-hand side, the maturity profile of our debt is extremely healthy, and we have no needs for financial restructuring in the near future. This all is, of course, then reflected on the balance sheet side. And I also already commented on the net debt side. But if we look at then the gearing as a result of the net debt development, gearing, we are on a positive track of decreasing the gearing. The small increase now from the year-end is, of course, related to the sale of our Russian operations and the impairment, what I just mentioned earlier, made. Interest cover ratio developing nicely to the right direction.

To conclude the financial performance from Q1, we just had a good start of the year. The profitability improved both in relative and absolute terms. Our balance sheet remained strong and we have very good

and healthy order book going forward. Thank you. And now, back to you, Markku.

Markku Moilanen

Thank you, Tuomas. And then, let's have a look at the outlook of the rest of 2022. Starting from the market, so Q1 was still very strong, overall, in our key markets, either normal or very strong. And of course, then what happened was the eruption of the Ukrainian crisis during Q1 as well. And since then, we have seen issues in availability of certain construction materials and some material prices have continued to increase as well. In addition, the general consumer confidence is weakening, which we expect that will be reflected in the housing demand as well. Looking forward, going forward, we expect the challenges in the market in terms of material cost inflation and availability to continue and the consumer demand to be a lower level than during Q1. But we see that that will continue at least during the next couple of quarters. On the other hand, we see that in mid and long term, the demand will come back because the need for built environment, the need for housing is there for longer term.

But let's elaborate a bit the material cost increases. And I would like to start by showing this picture of the material cost indices development. And this is something that started already in 2021. And then, of course, we started our actions and started to be organized in several task forces to mitigate the actions as well. On the other hand, if you see in this picture, see which is from Statistics Finland, you can see that steel structures have continued to increase whereas wood structures, actually, came down as expected at the end of 2021. And, again, these are results in March this year, and they're coming a bit late. So, we expect the material cost to – the inflation to continue moving forward. However, what we have done and, again, I want to emphasize that we started the work already last year when we saw the inflation to start. So, what we have done, we have gone through all of our projects, looked at what contract types we have, how much materials, which materials, we have a strong procurement organization actively contacting our supply chain, our people in the customer and client front, actively contacting other clients as well. So, all in all, if we think this is a case of an apartment building and we have, of course, done similar analysis in all of our different projects. But in a typical average apartment building, the materials are about one-third of the building price. And out of those – then those materials where both the earlier inflation is hitting, as well as the Ukrainian crisis represents 20% out of the 30% as well. So, that's where we have, of course, been focusing on.

And, again, the mitigation actions that we reported already during last year are, first, the active customer relations management, so very proactive dialog with the customers pricing adjustments whenever possible, dynamic pricing as we have, especially in the CEE countries in housing. Secondly, the contract management negotiations using the force majeure whenever possible, finding together with our clients the joint measures for the benefit of the projects. And, again, definitely for new projects to use indexing, use cost-plus fixed models and others like that. And then finally, our strong procurement where we have a task force where we have a total look at the whole company's procurement. And they have been able to find alternative materials, new supply chains, and sources as well. So, as said, during Q1, we have been successful in this. And we continue our actions and with a goal to mitigate as much as possible moving forward during the coming quarters.

Again, in the outlook, it's good to remind that the completions in this year, we are estimated to have on a lower level than last year. And the reason is that the – we had a lower level of start-ups in the beginning of the COVID19 pandemic as well. So, looking at the estimated completions in Q1 this year, they are relatively low level – actually zero in the CEE and then a bit more in Finland. And, again, like I was alluding earlier, we had a very good level – very high level of sales in Q1, and we expect that to normalize during Q2. So, overall, we see that the Q1, Q2 together in terms of revenue and profits in Housing is along our expectations.

And again, to explain a bit more our Housing completions and then the consequent revenue as well, so in this picture, you can see the blue line is our startup levels where we had some cautiousness in the beginning of the COVID-19 pandemic. And you can see that the average building is about – takes about 18 months, and you can see low level of completions than in the white line as well. But moving forward to 2023, the high level of startups will mean that the revenue – firstly, the completions and the revenue will pick up in 2023.

All in all, we will keep our guidance so that we expect that this year why the group's adjusted operating profit is expected to be higher than in 2021 in the continuing operations. And we keep looking at that. And in Housing, like I expected, we explained we expect the completions in consumer apartments to decrease a bit.

We expect our business performance in business premises and in infrastructure to continue to improve during this year. However, in infrastructure, where we have long projects that will be impacted for a while by certain legacy low-margin projects. On Property Development, we have several promising projects in the pipeline, which is promising not only for this year, but definitely for the years to come as well.

So, all in all, the foundation is set. We took tough actions last year to go through our project portfolio. We did the necessary margin adjustments. We developed our new strategy. And we clearly see that the mid- and the long-term prospects for our industry remain positive. We already see now after the eruption of the Ukrainian crisis that our strategy, our focus strategy where we concentrate on our core competencies that will help us to stay competitive even in the markets that are weakening. So, we will continue according our strategy, focusing on our profitable core and execute our strategy. Thank you very much. That was all from my side.

Tommi Järvenpää

Thank you, Markku. And thank you, Tuomas. Operator, we are now ready for the questions.

QUESTION AND ANSWER SECTION

Operator

Thank you. Our first question comes from Anssi Raussi, SEB. Please go ahead.

Anssi Raussi

Yes. Hi, guys. It's Anssi Raussi from SEB. I have three questions, and I take them one by one. The first one is that you mentioned that the selling price of – sorry, selling of Russian business has been proceeding slower than anticipated. Could you give some more information on what is the problem there? I'm sorry if I missed this one, if you mentioned that already. Thanks.

Markku Moilanen

Yeah. Thank you. Well, we are not facing problems. There are always certain steps in this kind of processes. And, of course, under the current circumstances, they take some time. But we are progressing according to the step, so no problems in the process. It just takes a bit longer time.

Anssi Raussi

Okay. And you wouldn't have any difficulties to get the cash from Russia?

Markku Moilanen

We don't see any difficulties in that. Of course, there are few steps to be handled before doing that, and that's what we are exactly doing.

Anssi Raussi

Okay. Thanks. And the second one is about pricing. In what kind of situations you are able to use force majeure in your pricing if you have to increase selling prices after the contract has signed or during construction and like what are the options for the customer in this kind of situation?

Markku Moilanen

Well, it's according to our contract rules. And, sometimes, again, we are having the dialog with the clients that how we interpret the force majeure, and that's why the approach is normally to have the best of both parties even in those cases. And we have had good dialogs and good solutions with clients as well. The general contract rules in Finland are a bit tougher than in Sweden where we, in normal situation, if things like now the abnormal prices of energy increasing, we get through in a much easier way. But in Finland, in some case, we have been successful with those as well.

Anssi Raussi

Okay. Maybe the last one from me is that you already talked about this a bit, but what is the situation and availability with your material purchases as your inventory value has decreased by 12%, but order book increased by 7%? So, is there anything to worry about or is this just something seasonal and totally normal?

Markku Moilanen

Yeah. That's purely seasonal, no – nothing to worry there. That's according to our plans and expectations.

Anssi Raussi

Okay. So, you have been able to purchase materials normally?

Markku Moilanen

Yes.

Anssi Raussi

Okay. Thank you.

Operator

Thank you. Our next question comes from Svante Krokfors, Nordea. Please go ahead.

Svante Krokfors

Yes. Good morning. Svante Krokfors from Nordea. Thank you, Markku and Tuomas for the presentation. Anssi actually asked a couple of questions but perhaps – that I had. But perhaps if I continue on that, on the delays in the Russian disposal, is the deal conditional on something or is it only kind of the approval process that is delaying it?

Markku Moilanen

Yeah. It is the formal approval. So, we have a very good relation with the buyer and they're very eager to buy, and all contracts are fine with them, and a very good dialog. So, it's the final approvals from the authorities, and then the banks that we are going step by step forward.

Svante Krokfors

Okay. Thank you. And then on, I mean, Housing division was stronger than even you expected. And you mentioned the mix as one. Was there any particular projects that impacted the margin positively in Q1?

Markku Moilanen

No, not really. The key reason, like I commented, was a very high level of sales, of our completed and unsold apartments. So, overall, it's the kind of the – the first half is what we expect to be in a normal level.

Svante Krokfors

Analyst, Nordea Bank Abp Q

Okay. Thank you. And then, thank you for the extra slides on pricing and materials. Can you explain a bit about – I guess, you have a better availability than your competitors. Could you explain a bit why that is apart from that you are probably the biggest buyer?

Markku Moilanen

Well, we have a long-term relationship with our providers and framework contracts. And, of course, we are a big buyer. So, we clearly have seen that we have been firstly prioritized by the suppliers, which we are, of course, very, very happy. But then we have been able to negotiate reasonable price increases in our dialogs that we are having with them as well. So, that is more or less as it is. And, again, our substantial procurement network has enabled us both by the existing suppliers to find new sources so that they are doing it, but then we have been very active on the market ourselves as well to find new material sources. And we actually see in the market that in some countries that the prices of, like, steel is already now going down because of the lowering demand, as an example.

Svante Krokfors

Okay. Thank you. And you elaborated on the contract structures have been adopted that – have you permanently kind of changed the way that the contract structures look in projects now during the last, say, 18 months given the current situation? And I mean, does the contract look very different now compared to before this situation? And will this be a permanent change that the customers accept it also?

Markku Moilanen

No. I wouldn't say that there is a major change. It's more the project selection from our side. So, fixed fee prices, contracting competition where we see too high risks on the material cost side. So, we then – we just say – have said no and we'll continue to do that as well. So, we are much more rigorously now starting already last year, calculating the cost risk not only material but total cost like workforce and others as well. And now, we are having active dialogues with the clients. I would say that that's maybe the change that is happening that we are sharing the risk and having areas where we have cost plus models. And so – and maybe that's the way forward as well to have a bit more open dialogue, and we are happy to do that. Then it looks like the big clients, both on the public side and – but then private side are ready for that kind of dialogue moving forward.

Svante Krokfors

Okay. Thanks. And regarding workforce availability and subcontracting availability, have you seen any bottlenecks there? And how do you look at wage inflation?

Markku Moilanen

We clearly see that no changes on that, that we have been reported. So there is still a shortage of site management workforce in the industry in all of the countries that we are working. On the other hand, we have been able to recruit, especially in the Business Premises, several key talents on that area. We're very satisfied on that. So we have been successful on that. We see kind of outside of the growth centers in Finland actually, actually the availability of workforce has been improved since the eruption of the Ukrainian crisis. So they are contacting us as well. Then, of course, we have the CEE countries, where already earlier there has been kind of shortage of workforce after the crisis that has continued as well. So far we have been successful and don't really see that as a bottleneck for our project in those countries either.

Svante Krokfors

Thanks. And you have earlier warned that the current situation with the high input costs could affect the demand. Have you seen much postponements or cancellations of projects in the market because of that reason?

Markku Moilanen

Not really notable in a big picture there, of course, some of those. Then we see a lower level of consumer reservations in apartments. But even that didn't go as low as in the beginning of the pandemic. That's the overall situation in showing the lower customer or consumer confidence. On the other hand, we have good examples on some very good locations where the reservation rate has stayed and increased very fast even since the eruption of the crisis.

Svante Krokfors

Okay. Thanks. And the last question regarding Property Development and you moved the wind park development into that. Is there are a lot of promising projects and what is your practice of informing the market about the developments there?

Markku Moilanen

Well, there are several very good, and the market is good and not least in the current situation where renewable energy in the whole Europe. We see that the share of renewable energy will increase. So, we have several good projects, and we are investing on that area. We haven't been really communicated earlier about the project and the progress. And of course, they normally take several years. But as there will be something to report, we'll inform the market about where we are with those as well. But we really see big potential on that area.

Svante Krokfors

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

Markku Moilanen

Thank you.

Markku Moilanen (OP)

Yes. Hi. This is Markku Moilanen from OP. I have two questions left. First of all, in Housing segment, your profitability was supported by a better sales mix. Now, if you look at the sales mix in your order backlog, how does it compare to Q1? And should we expect to see similar margin levels later this year as well?

Markku Moilanen

Well, we overall see that the sales mix will be in the whole year as kind of originally planned. It was – now, we're a bit more positive. And again, we're starting a bit higher than we expected. But that – we expect that to normalize moving forward.

Markku Moilanen (OP)

Okay. That's clear. Second question is about your outlook. Your short-term outlook in housing and real estate market is both in downwards. And you also highlight that consumers are getting more cautious and demand is expected to weaken. And also, the construction material availability is becoming more challenging. Taking all this into account, how confident are you with your guidance at the moment?

Markku Moilanen

Well, we have carefully analyzed the situation. And as we see the situation in the market than on our business, we definitely are confident at the moment.

Markku Moilanen (OP)

Okay. Good. That's all from me.

Operator

Thank you. Our next question comes from Anssi Raussi, SEB. Please go ahead.

Anssi Raussi

Yes. Thank you. One more from me. Just asking that you mentioned in your report that you have reached an agreement with the Hospital District of Southwest Finland, and you also mentioned that this agreement became final in April of this year. And the initial claim was €20 million. But I guess you won't be commenting this agreement. But still thinking if there are some one-offs we should be expecting in Q2 report. Can you comment anything about this?

Markku Moilanen

No, we are not commenting the details, but we are satisfied with that – the result of that one. Nothing to be expected similar one-offs in – during Q2.

Anssi Raussi

Okay. Thank you.

Operator

We have no further questions. Dear speakers, back to you.

Tommi Järvenpää

Thank you very much and thank you for the active discussion. Our second quarter results will be published on July 28. Until then, thank you, and goodbye.