Webcast transcript: Half-year report 1-6/2022

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PRESENTATION

Tommi Järvenpää
Good morning and welcome to YIT's Second Quarter Earnings Webcast. My name is Tommi Järvenpää. I'm the Head of YIT's Investor Relations. Our strategy execution continued in the second quarter. Profitability improved despite prevailing market instability. And the sale of the businesses in Russia were completed successfully. Next, our CEO, Markku Moilanen; and CFO, Tuomas Mäkipeska, will go through the Q2 results and highlights. After the presentation, we will be taking questions from the conference call line. At this point, I would like to hand over to our CEO, Markku. Please go ahead

Markku Moilanen
Thank you, Tommi, and good morning on my behalf as well. As Tommi commented, we continued to implement our strategy during Q2. The first part of our strategy is to focus on our core competencies and focus on businesses, which we see attractive and profitable growth in the future. And as a result, we completed the sale of our businesses in Russia. We have now stopped all operations in Russia and it's important to highlight that all the liabilities from 60 years of business from YIT and Lemminkäinen are now behind us. The sale of the Russian business is a clear testimony of the great expertise and commitment of our people, not only from the Finnish side, but from our former employees in Russia, who kept the business well running since the eruption of the war in Ukraine.

If we look at the profitability and the rest of the business, our operating profit increased despite of the prevailing market instability. The operating profit increased from last year's numbers. And more importantly, I would say that the profit margin telling about the efficiency of our operations and our productivity increased more than 1 percent point to 4.5%. While we have been very selective in our projects, especially in Business Premises and Infrastructure, we are happy that our order book was strengthened during the quarter as well. We signed significant deals during the quarter and even after that, like the new R&D Center for Nokia in Oulu, the seawater heat recovery tunnel for Helen. And right after the Q2, the Health and Well-being Centre in city centre of Helsinki, Kamppi in Finland. So just a good example of the order book, which secures the workload for the coming quarters and years.

If we look at the numbers during the second quarter, our revenue decreased, which was planned, and the reason for that was a lower number of apartment completions in Housing compared to last year's very high number during Q2 as well. Despite of that, our adjusted EBIT, as I just mentioned, increased and the margin increased as well. And it's really as the result of our productivity work, so lower level of project deviations and, again, more efficient operating model.

Again, all our businesses are in good shape. Yes, Housing, the – while the level of apartment completions was lower, their revenues lower, so naturally the EBIT was lower as well. On the other hand, our transformation in Business Premises and Infrastructure continues according to the plans and that can be seen in the results. The good results in Business Premises, it should be mentioned, it is driven by two self-developed projects during the quarter, one in Bratislava, Slovakia, and one in Turku, Finland. These were planned during this year, but came already during Q2. So, we have several of these, a bit smaller self-developed projects ongoing in different countries and that now we could harvest the good results from them. But I would like to highlight that even the underlying performance is improving according to our plans as well. In Property Development, yes, we had a stable result and our pipeline on developing self-developed projects looks promising moving forward as well. Just to mention, we have been investing clearly to the wind power development, which we see very attractive in the future. Two of the projects, Murtomäki 2 and Taraskallio are now under zoning. And we have hired several experts to strengthen our wind power development team as well.

The whole market has changed a lot during the first half of the year. So, we have seen the eruption of the war in Ukraine. We have seen the consequent inflation of material costs and challenges in material availability. And now lately, during the last couple of months, we have seen increasing interest rates and rising inflation, which has taken the overall consumer confidence down. So, of course, we have evaluated the situation, evaluated our strategy as well. And our conclusion is clear. Our strategy is the right one. And I would say that, just under these circumstances, it is the right one, because we are focusing on our core competencies and – where we are good and we can – where we can perform and grow profitably. Secondly, we are working hard to improve our internal productivity. And thirdly, we are preparing for the future to strengthen our position in ESG.

So, if we look at the progress during Q2 in these three strategic priority areas, firstly, yes, of course, in focus, the sale of the Russian business is an important milestone for that. In Property Development, we divested the IISY Oy. While not the largest transaction in size, it's a good example of our strategy execution where we are cleaning our portfolio and divesting our service business. Thirdly, we invested in attractive urban plots in Housing and again, of course, carefully selecting the plots, but we during this period invested in attractive plots in Poland, in Warsaw and in Kraków during the period as well.

If we look at our progress in productivity, firstly, last year, last autumn, we announced that we were designing a new operating model, which we implemented since the 1st of January this year. And of course, we had related cost savings targeted based on the new operating model. And we're happy to see that the progress has been very good on that. And during the first half of the year, we have already amounted of €14 million cost savings from the new agile operating model.

Secondly, in terms of productivity, we have gained substantial gains from our enhanced project management. So during the first half year, our project deviations have been clearly lower than during the past years. In addition, we are on track to reduce lead times in our Housing projects, so to finish our apartment houses in a shorter timeframe where our goal is to reduce that by 20% by end of 2025.

Looking at ESG, what I'm really proud is that we have already achieved our goal which we set in 2019, which was to reduce our own emissions by 50%. At the end of Q2, our CO2 emissions from our own operations was 51% lower compared to 2019. We are continuing our work to reduce our emissions in Scope 3 according to the Science Based Targets, and our process to approve the Science Based Targets is progressing according to the plans as well.
When it comes to health and safety, our combined lost time injury frequency was at a level of 12.0, and our focus has been on leading indicators, management walks and talks, and safety observations on our sites where we are well ahead of our targets. When it comes to the good governance, we have continued good work and ensuring that everybody working on our sites has a valid working permit as well.

I mentioned about our investments in the land bank, and it's important to highlight and understand that when it comes to housing and self-developed projects, a strong land bank in a good attractive plot is important for any company and, of course, for us as well. So, we have a land bank in Finland and in the CEE countries, and according to our strategy, we are strengthening that as well. And like we have told, we are seeking even more growth in the CE countries, especially in Poland, Czech Republic and Slovakia as well. And our land bank value was close to €700 million at the end of Q2. And this, of course, enables us to grow in a very profitable way in those countries in our Housing business.

At the same time, when we analysed our strategy, we, of course, looked at our overall strategic goals, even if we are looking the short term and clearly, all signs are indicating that we are heading towards a recession. We clearly see that our financial targets to reach over 6% EBIT by end of 2025 is still achievable and a right one. And we see that because our strategy is supporting us. We are focusing on our core competencies, we are increasing our internal productivity, and then we are growing in the attractive areas when the market growth starts again.

At the same time, we have – we are well-aligned in our gearing targets, so almost in our target which is targets which is below 50%. It's good to note as well that our gearing will increase in short term as we invest in growth and most importantly, in investments in new attractive plots and housing startups in those areas where there is a good market looking forward. And again, thirdly, yes, we are well on our way to have a stable growth on our dividend as well. So, we are keeping our strategic targets, financial targets, as they have been before. So, let's have a look, a bit more closely to our numbers during Q2, and I hand over to our CFO, Tuomas Mäkipeska. Tuomas, the floor is yours.

Tuomas Mäkipeska
Thank you, Markku, and good morning on my behalf as well. As Markku described, we had a successful quarter. Our profitability strengthened and the balance sheet remained strong. And let's have a look at the highlights of the – from the financial perspective.

First of all, the order book strengthened to above €4 billion, which is a very good starting point for going forward in the market situation where we are right now. The adjusted EBIT improved both in absolute and relative terms, and the net debt remained on a low level, especially when taking – or excluding the IFRS 16 and housing company loan effect there. I will cover these items in a while, but let's first have a look at the financial impacts of the sale of our Russian business.

So, we are, first of all, very pleased that the sale of the business in Russia was completed successfully. The total transaction price amounted to €71 million, and we booked an accumulated negative translation difference of €253 million, which did not have an impact on the group equity and cash flows. This led to a result for discontinued operations of minus €293 million. And as earlier announced as well, in Q1, we already booked an impairment of the assets related to the Russian businesses.

Now, looking at the order book and revenue development, and it's good to see that we were able to grow our order book to above €4 billion levels, which is, again, I think, great evidence of our competitiveness in the market, despite the selectiveness in the project that Markku already mentioned. And the majority of the growth in the order book came from the Housing business, but it was also supported by Business Premises and Infra business order book growth. This really safeguards our volumes going forward in the unstable market conditions. Our revenue decreased notably as it was also planned, mainly due to the lower number of completions in Housing, as Markku already mentioned. But also at the same time, we're able to grow our revenues in Business Premises and Property Development segments.

If we look at the profitability perspective, so the adjusted EBIT, we are able to improve both in absolute and relative terms. And productivity improvement, due to the new operating model, was one of the drivers behind the improvement. But in a big picture, it's clearly visible here that our diversified business model also protects us against the market instability and was then an enabler actually to overall profitability improvement in Q2.

The Housing EBIT was decreased notably due to the volume change, this meaning lower number of completions resulting from the slowdown – slowing down of startups because of the COVID-19. On the other hand, we improved the profitability significantly in Business Premises and in Infra business. In both segments, the turnaround has progressed well, and the margin deviations were decreased a lot compared to the previous years. Business Premises improvement was positively impacted by the two already mentioned self-developed projects, of which sales took place in Q2. These projects are business as usual for us, as Markku mentioned, but it's the timing of these projects that gave us also tailwind for just second quarter.
If we look at the capital employed and the cash flow development, so in the big picture, the cash flow and the capital employed development reflects our growth investments according to our strategy. The impact to both comes mainly from the plot acquisitions and higher number of apartments under construction in the growing cities in Finland and in CEE countries, as has been planned ahead. But of course, we continue the selectiveness in the project and risk management procedures to manage our capital employed level. But on the other hand, our strong balance sheet continues to allow us to invest in growth.

Our debt structure, it is very important to note that our debt structure and a low risk – financial risk profile is highlighted on the left-hand side here. If we look at the net debt excluding the IFRS 16 impact and the housing company loans, we would have roughly €80 million net debt. This is kind of reflecting the low financial risk profile of our company. And this is – I think this is very important to understand, because these two components are not, in the same way, interest and risk-bearing financial instruments as the other ones are. Also, if we look at the – on the right-hand side, the maturity structure of the debt, so it's healthy and there's only a minor payback coming in during this year and a bigger one at the end of next year. And this also is clearly visible here that we do not have any refinancing needs currently.

From balance sheet perspective, so as mentioned, our balance sheet remained strong, and it still allows us to execute our strategy going forward. As mentioned, the increase in net debt is related to the growth investments to plots and construction volumes, and it is also visible in the gearing development. Our interest coverage continued to improve, and the equity ratio remained on a healthy level. We see the strong balance sheet as a platform for growth and navigating through the unstable market environment.

So, to summarize, the well-progressing transformations and improvement performance drove our earnings growth, and we are well equipped to continue executing our strategy. Thank you. And now over to you, Markku.

Markku Moilanen
Thank you, Tuomas. And let's have a look at the market and the expectations moving forward. All in all, we expect our profitability and our profits to improve during this year compared to last year's number where we had – where our result was €85 million. However, it should be noted that the short-term market outlook is clearly cloudy. And like I mentioned earlier, all indicators are showing that we are moving towards recession.

If we are looking at the different markets in the different countries, we can clearly see several negative trends. Firstly, in the housing markets, we can see in Finland and in the Baltic countries, coming from a very good market to a more normal level, but the trend is negative, and the overall consumer confidence is clearly impacting the housing apartment sales in the Finnish and the Baltic markets. We clearly see a bit better situation in the Central Eastern Europe where the clear expectation is that due to the inflation, the apartment prices will continue to grow and many private citizens see investments in the own home to be a safe investment. So, sales is progressing clearly better in those countries compared to Finland and Baltic countries. In the real estate market, yes, we see the market slowing down again due to the overall market instability as well. On the other hand, going back to the history and looking at our position in that market, we already during the COVID time started to move more towards public sector projects and clients. And our - from our project base and order book, more than 70% already is from the public sector, which is, of course, during these bit more unstable times to come, very favorable for us. And we have a lot of good projects in our order book and in the pipeline as well. The infrastructure market is clearly the market which hasn't been impacted so much by the overall market change. So, the Finnish market remains as we see to be in a good level and the Swedish market is continuing to be good even if the competition is very, very tough in the Swedish market.

One thing which has clearly impacted the whole construction industry has been, like we have discussed one and a half years so far, is the building cost. Actually, Statistics Finland just released their building cost index, which is showing year-on-year building cost increased by 9.4%. And it's really the materials, which has been growing the most, so 15.3%, whereas labor increase was only 3.2%, and services, 1.6%. So, we are looking at our situation. Again, we have our actions to mitigate against the cost increases using indexing whenever possible, using our strong good relations with suppliers and our procurement organization, which been actually very, very important for us to ensure material availability on our sites as well. So, we've been able to get materials for all of our sites.

However, it should be noted looking – moving forward that even if we see that the material price development is stabilizing, some of the material price is even coming down, they are already on a high level and that will have an impact now in short term, especially for our Business Premises business as we have a few fixed price projects, which are still continuing during the rest of the year.

If we are then looking at the Housing business and like we have communicated the key KPI on our revenue and profits is the number of apartment completions. Looking at 2022, we are a somewhat lower level than in 2021. And the reason for that is the low level of startups in the beginning of the COVID-19 pandemic as well. And that's why we have the variability between the quarters moving forward Q2 completions were in a lower level and we expect them to grow moving forward.And other KPI, which is impacting our earnings and profits in each quarter in Housing, is our sales mix. Like, we communicated during Q1, we had a very favorable sales mix. So, the prices in the apartments were in a higher level, that normalized during Q2. Looking now at the rest of the year, our sales mix will be weaker even if the number of completions will grow as described in this picture as well.

And again, a slide that we have showed now during earlier quarter reports as well as showing that why are we having a dip in the consumer apartment completions. And that's the reason, the blue curve here, where we had a lower level of – actually we stopped startups for a while due to the market uncertainty at the beginning of the COVID-19 pandemic. Now moving forward, because we have increased the number of startups, we expect the completions to grow as well.

So, all in all, looking at our guidance, we keep our guidance, which is that we expect our group adjusted operating profit to be higher than 2021 when it was €85 million. And again, the factors in each segment impacting the operating profit are described here as well. So, Housing, it is the completions especially, but the sales mix as well. We are looking at the Business Premises, we expect the transformation, good progress in our transformation to continue in Business Premises. I'm very satisfied with that. And again, like I mentioned earlier, the project deviations have been on a lower level in Business Premises and Infrastructure compared to the past years. We see the same positive trend in Infrastructure as well, even though there are a few legacy low-margin projects, which will continue for a while. In Property Development, we have, like mentioned, several promising project pipeline. I would like to mention one, especially which is the renovation of Maistraatinportti business centre in Länsi-Pasila district. So, we are not just renovating a building, but creating a new kind of working environment that supports employee well-being after the kind of pandemic. And we have already signed a lease agreement with our anchor tenant, a private employment service company, Eezy Plc, in that one. And so, that progress focusing on our core competencies on Property Development moves well as well moving forward

So, to summarize, looking short term and more kind of medium and long term, yes, we have subdued cloudy outlook short term as we're heading towards recession. On the other hand, we will be focusing on rigorous strategy execution which will give – already has and will give us a competitive advantage moving forward. We have a strong balance sheet, as Tuomas explained earlier, and that enables us to select when do we want to grow and when it's time to grow, especially in Housing and in Property Development as well. That withstands us against cyclical changes as well.

Our new diversified business model and our strategy where we are focusing on our core competencies is supporting us. And again, like I mentioned earlier, our new operating model has already gained us savings in costs and our productivity has increased as well. And our investments are geared towards future growth and opportunities, attractive plots. Of course, we are carefully looking at the market development, carefully looking at plot investment, evaluating housing startups much more carefully in the prevailing situation than before and therefore, stabilizing the situation.

So, short term, we believe that even if the market ahead of us is cloudy, maybe even sometime stormy, so we believe that with this model, with our capable people, we can navigate through the storms, and we are prepared for the long-term success of the company. Thank you very much from my behalf, and now I think it's time for questions

Tommi Järvenpää
Yes. Thank you, Markku. Operator, we are now ready for the questions.

QUESTION AND ANSWER SECTION

Operator
Thank you. Our first question comes from the line of Svante Krokfors from Nordea. Please go ahead.

Svante Krokfors
Good morning and thank you for taking my questions. Regarding your cost savings of €14 million, sounds good. I was a bit disconnect there. So, could you perhaps repeat where those cost savings mainly come from and what's the focus area there?

Tuomas Mäkipeska
I can comment on that. Basically, the €14 million cost savings, it was due to the, as Markku already mentioned, so due to the operating model and its implementation. And the cost savings are regarding the fixed cost levels in the company and the source of the cost savings came from both – from the group operations and all of the segments. So, that's basically the reason behind that.

Markku Moilanen
And it's both personnel FTE savings as well as other operating costs.

Tuomas Mäkipeska
Yes.

Svante Krokfors
Okay. Thank you. And then can you give some guidance about the EBIT impact from the sale of the two self-developed projects in Business Premises?

Tuomas Mäkipeska
Well, as mentioned, so the Business Premises result was, of course, positively affected by the sale of these two projects. And basically, we are not disclosing exact numbers from specific projects, but it had an impact of several million euros on our results.

Svante Krokfors
Okay. Thank you. And how do you reason about startups in the current environment, especially in Finland, given the development? How do you reason around that?

Markku Moilanen
Well, like I mentioned, we are carefully evaluating all startups. And, of course, we are back to the very fundamentals of real estate business and housing as well. So, it's about location. It's about the apartment mix as well. And so, all in all, we are more careful than before. We are evaluating the reservations levels and – when making the decisions moving forward. But we clearly have a plan to continue those moving forward.

Svante Krokfors
And your apartments under construction for investors has remained quite stable. Do you have any comments on the demand outlook there? Is it only funds that have raised money and need to deploy that money, or do you see also other parties being interested?

Markku Moilanen
Yeah. We see that, in general, the investor market kind of has remained kind of quite stable. The interest remains there during the quarter.

Svante Krokfors
And that probably goes for commercial buildings also. You said that 70% is from the public sector within Business Premises. What does the competition look like in that segment? Has there been any changes?

Markku Moilanen
Well, I would say that it's been the whole pandemic, the situation has been like that. So traditional offices and commercial locations, too much of those been built during the pandemic and that competition kind of we clearly saw kind of competition to increase, because others were coming to that market as well. But no changes now during the first half of this year compared to what it has been in the last couple of years

Svante Krokfors
Okay. Thank you. That's all the questions I had.

Operator
And the next question comes from the line of Robin Nyberg from Carnegie. Please go ahead.

Robin Nyberg
Hello. Robin Nyberg, here. It sounds like you are not planning to reduce housing starts now and still you expect the market to move towards a recession and we have all-time low consumer confidence in Finland. So, isn't there a risk that the profitability in housing will decline if you are still aiming to grow in housing in a weaker market?

Markku Moilanen
Thank you. Good questions. I would like to kind of remind the one slide and what happened in the beginning of the COVID-19 pandemic. So, making a startup now this autumn after this summer practically means that we are finishing – completing the house in 2024. So, we are really looking for more the long-term growth. And when we are talking about short term, we are definitely talking about this year and next year as well. So, it's more investment for the future when we are talking about apartment startups that we are doing now. The completions that are coming in now during the rest of the year are projects which are under production currently. So, we need to kind of differentiate the short and long term, and that's why we have a strong balance sheet and will use to the profitable growth in the future, which we strongly believe that we will see that in the coming years.

Robin Nyberg
Thank you. Fair enough. Then, coming back to Svante's question related to Business Premises where you had a couple of divestments that supported margins there. Could you comment about the underlying profitability level? And I think you also mentioned some headwind from cost inflation in second half and if you expect this underlying margin improvement to continue to improve in second half despite a couple of more challenging projects?

Tuomas Mäkipeska
Yes. The underlying performance in Business Premises continued on a good level. And as mentioned, so the transformation is progressing there well as well. A good – very good indicator on that is also the margin deviations from the projects that we were able to decrease significantly from the previous year. So, that's one kind of a source of operational performance there. On the other hand, also, the cost inflation hits the toughest in Business Premises so that has had an impact already in Q2 and will also have impact going forward in Q3 and Q4. But in the big picture the underlying performance was improving.

Robin Nyberg
All right. That's all for me. Thank you.

Operator
And the next question comes from the line of Olli Koponen from Inderes. Please go ahead.

Olli Koponen
Hello. Olli Koponen from Inderes. Thank you for the presentation and taking my questions. Most of my questions have already been answered. But I would just like to know do you kind of expect other these kind of self-developed Business Premises projects to be sold during this year or was this it?

Markku Moilanen
Well, we have several of these kind of smaller development projects ongoing all the time. These two were planned a little bit later, originally, this year, and now they were finished their sales already during Q2. In Business Premises, we are not expecting more of those to come during this year.

Olli Koponen
Okay. And then on the interest profitability, do you kind of see the same kind of cost inflation challenges there as you see in Business Premises in H2?

Markku Moilanen
If we look at our project base and order book, it is more common in the infrastructure projects to tie the material prices into indexes. And again, that is protecting us somewhat more in the Infrastructure compared to the Business Premises. So, that is a key reason that we see. Yes, it has impacted, but it's not really material in the infrastructure where our project performance and transformation is clearly giving us kind of much better results than the impact on the material prices.

Olli Koponen
Okay. Thank you. That is all from me.

Operator
And we have one more question from the line of Mika Karppinen from Danske Bank. Please go ahead.

Mika Karppinen
Yes. Hi. Good morning. So, concerning to some of the housing operations, in Q2, you signed a big 300-rental apartment deal with OP-Rental Yield fund. Are you looking for signing new similar deals more going forward?

Markku Moilanen
That is a part of our normal business model and the sales mix as well. This was notable. And we are having negotiations and discussions all the time, so it's premature to tell when and with whom. But those are discussions that we are having, and we are very glad of that deal. It's a good deal for us and OP as well.

Mika Karppinen
Okay. Good. Thanks. And then concerning the housing still, so have you noticed any decreased cancellations in the pre-sold apartments?

Markku Moilanen
Well, there has been a few, but not really in the big picture a lot of cancellations. Of course, the overall consumer confidence has – we can see that in the overall interest and the sales times are much longer than they used to be in a very hot market.

Mika Karppinen
Okay. And then the final one, what about the pre-reservation rates in the new projects which you are starting? Have you raised the bar before starting the projects?

Markku Moilanen
Yes, definitely. So that – when the market was extremely good, we lowered the bar. And now looking forward, we are more careful about that. On the other hand, like to remind my comment earlier that we are looking for more for long-term growth on that. But of course, it's about risk management, which we are rigorously following up during these circumstances. And it's the level of capital employed and our gearing, which we will have in control when doing the startups.

Mika Karppinen
Okay. Good. Thank you. That's all for me.

Operator
And as there are no further questions, I will hand it back to the speakers.

Tommi Järvenpää
All right. Thank you and thank you for the questions. Our Q3 results will be published on October 27. Thank you and have a great day.