Conference Call Transcript

Q3 2009 Sanoma Corporation Earnings Conference Call

Kim Ignatius - ***Sanoma Corporation - CFO***

Good afternoon, all, and welcome to Sanoma's third quarter conference call. My name is Kim Ignatius, and I'm the CFO of Sanoma Corporation. And with me here today I have Anna Tuominen, in charge of the Investor Relations.

Ready for Upturn

I am using a PowerPoint presentation to support my opening words. This presentation you can follow on our Internet site.

On first line, the headline used in this morning's presentation is ready for upturn. With this headline, we'd like to point out all the actions we are currently taking to strengthen our short-term and long-term profitability and competitive position. We have a lot of restructuring efforts ongoing, and these efforts will continue also during the balance of the year.

Our operating expenses so far have been cut down during the period from January to September by 6.7%, including also good sized personnel reductions. Some of the effects on personnel costs from these reduction programs are starting to be visible now in the Q3 numbers, and continue to play a bigger role going forward.

We do have non-recurring restructuring costs from these programs, adding up now to EUR17.1 million for the first three quarters. We will continue to book non-recurring restructuring costs for the programs that are executed and decided upon during Q4.

What comes to the environment surrounding us, we do see weak signals on the markets, on the total economies in the markets we are operating, but also in our own operations in improving advertising trends. These are weak signals and are not yet indicating a turnaround in the actual underlying operations.

Key Events Q3

I would like to point out some of the key events that have taken place during the third quarter, first starting with the structural changes.

We have closed down a sales channel, a Felicitas hostess organization, in the Netherlands, which was part of our Magazines operations. We have also divested, again in the Netherlands, as part of our learning operations, some educational magazines. Both transactions are to improve our profitability going forward.

At the same time, when having efficiency programs ongoing, we do continue developing our services and products. As part of Welho's operations, we have launched a new pay-TV channel package, offering real extensive customization possibilities to our customers.

We have also acquired a comparison site in Budapest to strengthen our online operations. We have also renewed one of our leading women's weekly magazines, Margriet, in the Netherlands. So a lot of positive product development programs also ongoing.

Very lately, we have launched a sports fantasy game for the Swedish markets. This being for us a new opening, entering a new geographical area, with our games operations being part of the Entertainment division.

Some trends and acknowledgements in our operations. We do see the number of newspaper and magazine readers growing in the Finnish market, this especially regarding two of our products, Helsingin Sanomat, the daily newspaper, and the Me Naiset magazine. This, of course, is a positive trend in the existing marketplace.

We have received an acknowledgement from World Association of Newspapers on our supplement of Obama in our daily tabloid newspaper, Ilta-Sanomat. Why this is important is that it indicates that we are really putting an effort to improve the quality of our tabloid newspaper, to lengthen and to strengthen its lifetime, and to slow down the declining volumes that we have seen regarding this paper, and in our view being very successful in doing that.

Streamlining Continues

Moving over to slide number four, here we are describing a lot of programs in our streamlining operations that have been ongoing during this year, and also will continue in Q4 and going forward.

We are redesigning Sanoma News' editorial and marketing processes and, while doing that, reducing the number of personnel in the News division. We are renewing Sanoma Magazines' Belgian organization. We are combining Sanoma Trade's Estonian operations. We are renewing Sanoma Uitgevers organization by separating the print and online operations, giving both of these that focus that the functions are needed to be successful going forward. And, finally, we are restructuring Sanoma Learning and Literature's multi-volume books and integrating the language service operations.

With all these programs, we are targeting to reduce cost levels. And as said earlier, so far we have been able to cut costs by 6.7%. And as you might remember, our target for the full-year is to have operating expenses clearly below the level of 2008. All these programs are not only to cut costs. They are also to redesign, to renew, and to develop our processes and services so that in the changing market environment we can be even stronger going forward.

Key Figures

We can see that our net sales came down by 9.9% for the quarter, when the decline cumulatively currently is at 8.8% level. There are, of course, natural variations between that month and the quarters. The decline level still indicates that no real turnaround has taken place.

Looking at the operating profit excluding non-recurring items, cumulatively we are 27% below last year, and for the last quarter, 16% below last year, indicating a clear improvement in the efficiency. The percentage of net sales of operating profit is 12%, which is a very good achievement. Last year's comparable quarter being only 0.9% higher. Also, the cash flow from operations was close to last year's level, being EUR0.70 per share.

Moving to slide number six, where we are building a bridge from the EBIT for the first nine months in 2008 to the EBIT excluding non-recurring items for the first nine months in 2009, here you can see the divisional impact on the Group level EBIT development.

The trends that you can see here have pretty much been the same developments that you have been able to see after Q1 and after Q2.

In the Magazines operations, the decline in profitability comes from decreasing advertising markets and advertising sales for our operation, as well as decreasing single copy sales. And mainly in two geographical areas, being our Magazine operations in the Netherlands and our international markets. The single market being hit most by the decline of advertising revenues is Russia, where the total media advertising markets has declined by close to 40%.

In News, the decline is coming from advertising sales, and especially in classified ads.

Entertainment has performed really well during the whole year. Our TV operations have taken market share. The TV advertising market has come down by around 13%. And at the same time, we have been able to keep our net sales pretty much flat. So, I’m very happy about the performance of the division.

Learning and Literature is impacted by many factors. One is that we did an acquisition in Poland, Nowa Era, last year. This is the first year we have Nowa Era included in our Q1 operations, and in the educational publishing Q1 is always a negative month. So, technical impact of this in our this year numbers. What is being hit by the economic environment is our language services, and especially the training services in the language service business. Also, currency translation has had a major impact. Roughly half of this negative trend here comes from the currency translations.

What comes to Trade, Trade's domestic Finnish business has performed very well. And we can say that the retail business here in Finland has been fairly recession-proof. The same doesn't apply for our businesses in the Baltic countries, whereby our kiosk operations and movie operations have really suffered from the struggling economies. Also, we have had profitability issues in Russia and Romania, partly because of the market conditions, but also partly because of some operational matters, which we feel are being corrected. And we are moving to a better operational profitability going forward.

Moving to slide seven, and coming back to the good performance in our profitability, if we look at the right-hand side of the slide, EBIT excluding non-recurring items, first, we can see the -- looking at the 2008 four quarters, we can see that the volatility between the quarters [which is] the natural -- annual profile that we do have between the quarters.

But then comparing the performance between 2008 and 2009, we can see that we are improving our profitability all the time moving from one quarter to the following quarter. So very pleasing development from this perspective.

Moving to slide eight, stable financial position, no new major development during this year in our capital structure or our financial position. Our net gearing has increased a bit. But at the same time, you can see that the equity ratio is pretty much on the same level as we had it a year ago.

We do have a favorable long-term credit facility, and do not have any refinancing issues going forward. We are pretty much fixed with our current credit facilities until 2012. Our net debt-to-EBITDA ratio, currently at 2.8. Our target is to get the ratio we want, below 3.5, and in -- under current circumstances, even at a lower level.

Outlook for 2009 Unchanged

Moving to slide number nine, our outlook for 2009 is unchanged. We have changed the outlook on the divisional level, strengthening the outlook for Sanoma Entertainment and weakening it for Sanoma Trade. Both these changes, mainly based on the three quarter performance that we already now have behind us.

Then the final part of the opening presentation here, Sanoma's strategy on slide 10. This is a summary of the strategy that we came out with in the beginning of the year, the end of last year, targeting to be one of the leading media companies in Europe, with focus on sustainable growth and profitability.

In this summary, we outline the strategic objectives for Sanoma Group. And what I would like to point out right now is the objective of strongly developing and expanding our online assets going forward.

We have worked on our online strategy, and as conclusion have reached an understanding of targeting doubling our online revenues by 2012. And when discussing the online revenues, we do not, in this perspective, include the TV or the broadband access in the underlying current revenue levels.

How are we going to reach this increased revenue level? Partly with acquisitions, still understanding that the valuations of many of the online assets are, even during this recession, at a fairly high level, but doing acquisitions when feasible. But at the same time, building on systematic innovation and R&D using the knowledge that we have inside our Group.

The focused areas are on transactional comparison and classified sites, trying to move our focus into areas of the online business when the earnings models are more positive to us. In addition to transactional comparison and classified sites, the focus areas include casual gaming and verticals. Our geographical focus will continue to be in different parts of the European marketplace.

Concrete actions that we have very recently taken, is that we have formed an organization called the Future Media Team. And in this team, we have the presidents of the three media divisions. These three persons are taking this strategy forward. Under the leader team here, we have, for example, online execution teams for the implementation of the strategy, and we have innovation teams to build our operations around thematic teams, for example. These teams are built from the expertise that we have across the borders, across the divisions.

Questions & Answers

Q: Maria Wikstrom *- Handelsbanken Capital Markets - Analyst*

I still have two questions, which the first one is relating to the number of employees going forward that are -- at the end of 2009 the Company had roughly about 17,000 employees. And as said, most of the employees [get] out of the [pay checks] in the Q1 of next year. So how should we see the number of employees evolving after Q3?

And then my second question is on the online, or the target for the online business to grow -- double it by 2012. So am I on the right ballpark expecting that -- the sales currently is roughly about EUR200 million, and doubling that would mean getting EUR200 million more sales from the online business?

A: Kim Ignatius *- Sanoma Corporation - CFO*

So let's start with the employee amounts. If we look at the current status at the end of September, so we have reduced our employee base by close [1,500] people. Most of these reductions have been outside Finland, so they have taken place already.

If we look at the balance of the year, you could say that we will probably, towards the end of the year, add some 200 to 300 people to our headcount because of the seasonality of our businesses. And, of course, these 200 to 300 will then be reduced automatically during the coming months and quarters again. But the kind of [tiny] volatility between the end of September and the end of this year is roughly 200 to 250 people.

And going forward, then we have some program like Sanoma News early retirement plans, which have been announced already, where none of the people have yet left the Company. So they will be leaving after this calendar year, and that is roughly 140 people altogether.

And then we do have some other programs already mentioned, like Sanoma Magazines in Belgium, where the process is ongoing. And we have announced over 60 people to be targeted in that program. And we have the restructuring of (inaudible) News, which could lead to another 60 people in additional restructuring.

So that's what we currently have on table. It's, of course, possible that some new initiatives could be coming up during next year.

What comes to the online business, I have also seen some of the reports we have received from the markets, that the EUR200 million mentioned as a baseline. I would need to take that number down a bit because that number would include our TV operations and also our broadband access people -- business.

So the base number is somewhere there, let's say, below EUR150 million rather than EUR200 million -- EUR120 million/EUR130 million levels. And that's the amount of revenues that we're planning to double going forward. These are, of course, rough numbers, and indicative numbers of the kind of mid-term ambition level that we have said to ourselves.

Q: Maria Wikstrom *- Handelsbanken Capital Markets - Analyst*

I think on slide 13, how should I -- how do I get the EUR150 million? Because I'm now looking at the dark blue columns, and I think the sales have already been EUR150 million from the online operations from the first three quarters, or is there something that I'm currently missing out?

A: Kim Ignatius *- Sanoma Corporation - CFO*

No, but in this kind of blue graph that we have here, first of all, these are quarterly numbers. So you have to take the annual picture and then you would need to take away the TV and radio and also the broadband.

Q: Niklas Kristoffersson *- Credit Agricole Cheuvreux Nordic - Analyst*

Thanks for taking my questions. I have three, and I guess I'll take them one by one. Firstly, on the cost base, you managed to reduce that by roughly 7% year-to-date. Would it be possible just to give an indication if you split that up by fixed costs and variable costs, and if there are any material FX impact in there as well?

A: Kim Ignatius *- Sanoma Corporation - CFO*

Well, first of all, we gave you some information of the cost base in the Capital Markets Day presentation and material; that might be helpful for you if you look at them. And we are actually updating it for the nine-month period, and this will be today available on our website. And maybe I'll comment a bit without going into exact numbers.

So if we look at the paper costs, the paper costs have come down quite a lot because of lower volumes, and basically based on fair flat pricing on paper. Overall, the variable costs, the cost of goods sold, surprisingly well has developed according to the declines that we see in the net sales. So on the gross margin levels, we haven't really lost profitability.

Then looking at personnel costs, we are currently around [EUR50 million] cumulatively below last year's level. [EUR50 million] doesn't sound a lot. But if you remember that we had 3% to 4% increase in salaries as a base to start with, that means then that we have actually been able to reduce more than 4% on the personnel costs, and now are actually for the first time seeing a decline even on the euro values.

A category where we have been able to cut a lot is advertising. We are almost EUR30 million below last year's level in advertising. And I do believe that this is still not hurting our business, because most likely we are having close to the same share of voice, even with this lower level of spending. And going forward, I do believe that part of these savings can be maintained. So it's not only cutting, it's also doing things better and really focusing on which titles and which products to support.

And then in each of the other operating costs, fixed operating expense category, we do see similar type of reductions. But marketing is clearly the single biggest category here; costs developing according to the sales trend, and paper coming down according to the volumes.

Q: Niklas Kristoffersson *- Credit Agricole Cheuvreux Nordic - Analyst*

Okay, perfect. I guess my second question, in your domestic News operation, how dear are market shares to you in the printed tabloid market? And can you also please comment a bit about the potential to [hike] prices there, as we have seen other media companies do in the Nordics?

A: Kim Ignatius *- Sanoma Corporation - CFO*

Okay, so how much we would aim to keep the existing market share levels, is that what you're saying?

Well, if we look at the development in our market shares, those have been fairly stable. We have currently around 57% market share. No major changes there.

Mikael Pentikaeinen, in today's press meeting and analyst meeting, said that we would actually meet any kind of price reductions that our competition would implement. In that way it is clear that we will not give away market share if we feel that we can financially, in a feasible way, keep that.

That has been the [trend]. Some -- or actually our sales in the tabloid business have been fairly good. So it means that we have been able, with our pricing strategies, to improve our sales development even when safeguarding our market shares. I don't know if I answered your question.

Q: Niklas Kristoffersson *- Credit Agricole Cheuvreux Nordic - Analyst*

No, absolutely. I'm getting a better picture. My third question, just on your, what you call, upscaled acquisition ambition, if you just can remind us a bit about the potential that you have in the balance sheet for acquisition. And if there are any possibilities to use your own share as currency as well.

A: Kim Ignatius *- Sanoma Corporation - CFO*

Yes, if we look at the capital structure the way it is today, and if we can start from the net debt-to-EBITDA ratio target that we have, then it leads to the conclusion that there isn't a lot of flexibility if we want to keep the ratio somewhere around 3. If you would push it and go to 3.5 then, of course, you would add some, but that is not the current thinking. So, limited flexibility.

When we say upscale merger and acquisition ambition, one area this relates to is the execution of the online strategy. And here, of course, the standalone single acquisitions might be of lesser euro amount, so we might be able do, within our current balance sheet structure, multiple smaller acquisitions. And, of course, we do create additional cash flow, and with that acquisition currency while going forward.

It is clear that if we would like to do bigger transactions, let's say in the area of Learning for example, then our current capital structure doesn't really allow for it, and then other measures would then be needed. Improved profitability also always helps us to have more flexibility. Then working with the business portfolio could give some opportunities.

Asking about could we use our own share, in theory, yes, we could. And we do have a mandate to do that, but there's absolutely nothing on the table right now.

Q: Alexander Wisch *- Standard & Poor's Equity Research - Analyst*

I've got a couple of questions, particularly on the restructuring charges, what we can expect going forward. I know it's hard for you to tell us now because of the depending on how people take redundancies and continue to take redundancies into next year, but any guidance would be much appreciated.

A second question related to that is Sanoma News. From the EUR17 million that you've had in restructuring charges this year, EUR8 million, I think, is Sanoma News and you have saved EUR30 million so far. What can we expect in terms of fourth quarter variance, particularly in Sanoma News? And can we expect restructuring charges to continue all the way to the end of 2010, or at least to the first half?

And the final question is basically the -- on margins. It's related basically also to the restructuring charges and to how much you continue to manage these savings. But do you expect to return to an EBIT margin above 9%? And if so, when?

A: Kim Ignatius *- Sanoma Corporation - CFO*

9% on which operation?

Q: Alexander Wisch *- Standard & Poor's Equity Research - Analyst*

The whole Group.

A: Kim Ignatius *- Sanoma Corporation - CFO*

Okay, well, a lot of questions so you'll have to remind me if I forget some of these. What comes to giving guidance on Q4 restructuring costs, you partly, Alex, answered your question yourself, saying that as long as you have negotiations ongoing, and things are a bit open, it is difficult to say where the final levels would be. A good example would be our program in Belgium, for example, where it is not exact where we will end up and there are a lot of processes with the employee representatives and so on, ongoing.

I can't give you, and we don't give, quarterly guidance in any case. But let's put it that way, that like, cumulatively, we now have had EUR17 million. That's the cumulative level. And we do have some fairly good sized restructuring operations that we have announced to the market. That's related to the Belgian project, and also related to the [daily net here]. So there will be a good sized amount, but I cannot explain you in more detail.

A: Anna Tuominen *- Sanoma Corporation - IR Manager*

It was also mentioned today that since we don't know the exact timing of the Belgian solution that might be pushed even to 2010 if it's not solved quickly.

A: Kim Ignatius *- Sanoma Corporation - CFO*

But I will look at these non-recurring items in such way, first of all, we really only book non-recurring items if they clearly relate to exits of businesses, or shutting down full functions, or redesigning whole operations. So those are the only big efficiency programs. And we only book amounts that in single cases are over EUR1 million.

You are right that out of the EUR17 million, EUR8 million is relating to News. And News has not announced any new programs, meaning that for that division there isn't any non-recurring items of these types or sizes to be seen.

What comes to returning to a certain profitability level, and when I think the transparency is still very bad, it's very difficult to see how quickly the market will recover. We have 20 different markets and then many different businesses, so I don't think there is a person who could really say when all these markets starts picking up and so on. And, of course, a pick-up of the market is required for us to have a significant improvement in the profitability levels.

We still today have the target of having 12% as an EBIT level for the Group. It is a tough target, and it did get even tougher during the last 12 to 18 months or so, but it hasn't been removed. And I guess in today's environment it indicates that we will, of course, fight for better profitabilities going forward. And it can include structural changes, it can include improvements of the businesses as they are, but I can't give you a clearer time.

Ending

Kim Ignatius - *Sanoma Corporation - CFO*

Thank you. If there are no further questions, I want to thank you for participating and thank you for the good questions you already raised. And I hope to hear from you again after one quarter. Thank you.