Cargotec Corporation
Thursday, 21st July 2011
11:30 Hrs UK time
Chaired by Mikael Mäkinen

Moderator

Good afternoon ladies and gentleman and welcome to listen to Cargotec second quarter 2011 presentation. Today we have a small live audience here in Helsinki and also people on the phone line. We will start with the presentation by our president and CEO, Mikael Mäkinen, and after that we will have time to answer your questions. Before asking a question, please ask for a microphone. State your name and company. We are ready to start now and Mikael, please.

Mikael Mäkinen

Okay, thank you. Welcome everybody. Following the normal procedure, we go through the quarterly report for 25 minutes and after that you have time for questions and clarifications.

January to June. Market activity was good in both segments and all geographies. I will come back to some details a bit later but it picked up in most parts of the world. Order intake in Q2 grew by 4% and sales by 25% year-on-year. Operating profit increased to 6.8 - I will come back to the details of it later. Although we are ramping up production, we have some more stocks being built up for coming deliveries, our cash flow remained healthy. We also started a global competence centre for container terminals in Singapore. I think it's a small centre but it's a very vital part in our reformation of the terminal basis.

Market environment, if you took the load handling equipment, developed positively. As you can see from here the demand for loader cranes, truck-mounted, day-lifts grew rapidly and as such, in Q1, recovery in construction-related customer segment in the United States is low. I think it will be low for a considerable period. Let's have a look at the container handling equipment imports. They are as we have said here, rubber tyre country cranes was very strong and that's because of the activity in imports. If you look at the market in general, I must say that there is a big number of projects. They are related to automated ports, they are related to upgrading ports for bigger ships and so on, so a considerable number. We have seen the projects developing, discussions being more intense, we have not seen many of the orders but I am quite confident that they will come in Q3 or in Q4 but I'm quite positive about the container handling market.

Marine, healthy level, we have seen big ships. For us, very interesting ships being ordered. Interesting for us means that there's a big revenue per ship for us, as I told you before. Some ship types might have six to eight times higher revenue per ship than a normal, very simple cargo vessel. So the fact that the bulk ships, number of them all being ordered is going down is not a very big concern for us. Also, on the marine markets here, fairly healthy development.

In load handling and terminals we have seen a good improvement in service as well and different types of modernisation packages. On the other hand, marine service, as I already told you after Q1, marine service is recovering, but there is not a big recovery at all. And I think that that's a shift in the market. The shipowners are much more cost conscious than before the crisis, so to expect a huge recovery in marine service I think is unrealistic. But a good development, yes.

Key figures, order intake. In my opinion a good order intake, taking into consideration that we have not seen the big projects in the order intake yet. Giving us an order book of 2.3 billion, we have to remember that we have a huge big order book in marine and now we have more on a normalised level. Good saves. On this level, a good operating profit, 54 million is good – 6.8 is okay but if you then we will go into the details, there are areas I am happy and there are areas I am less happy in the development.

Cash flow. Not on the high level as we have seen one year before but still on a very good level and we are looking very much up, so I think that this is a good figure, 71 million for the first half year.

Industrial and terminal order intake, 25% growth year-on-year, half of it coming from EMEA. Strong growth in Asia-Pacific. Yes if you look at the figure and compare it to Q1, it looks like it's going down, but on the other hand if the normal base business is on this level, if we add to that bigger projects we are on a healthy level; meaning that I see the coming quarters as very interesting from the order intake point of view in industrial and terminal.

Marine. We had a lot of bulk carriers one year ago, now offshore is recovering. Container is recovering. How do we see that? If you now look at the trend, yes, it could look worrying that you come from 309 million, almost like a downward trend, but the number of projects we again here see in the pipeline is very interesting. I don't see us going fast down. I see the coming quarters being very interesting in marine as well. Please bear in mind that we are on a much higher level than we were before. So there's a timing issue. In big projects in terminal, in marine, one quarter is a very short period. If the orders come in the first of July, yes, it goes on to the next quarter and so on. But fairly positive.

Sales. Industrial and terminal; yes that's where we're ramping up; grew by 34%; marine 13%. Very in line with what we had said about the forecast for this year. Industrial and terminal operating margin 4.5. Yes it's the right direction, yes it's not a catastrophe, but no, it's not an area where we could be very happy about that. I would have liked to have it on a higher level.

What is happening here is that we see, as you have seen in many other companies that there is a cost inflation. There is a pressure on costs and we can not, although we would like to do it, we cannot as quickly as we like pass it on to our end customers. There's a squeeze in the market. There's actually a squeeze in some of the components that is affecting us. It doesn't change. It doesn't change our target for this year or our long term target. No, but we reach it, the long term target, not as fast as I would like us to reach it. On the other hand we are also ramping up. We must have a good capacity for coming orders for maybe an even more difficult market condition in terms of costs. So that's why you see us building up some of our stock. On the other hand… okay I will come back to the gross profit a bit later.

Marine. We have said that we will not be on this very high level that we will come down to a normal level which is about 10%, and this is many, many quarters ago and we are still on a very good level. So what's happening here? We have a good mix, yes, the boom in order intake is over but still the order intake is on a very good level. I'm even more confident than before that we will always see a double digit margin here and maybe a figure that is well above 10 as well. We have a very, very good operating model here in marine.

Gross profit. Some comments, people were worried about it going down, going down, going down. Now it has turned back. We are incurring some costs, that's why you don't see the gross profit development coming fully through the profit of industrial and terminal and then you have to remember here as well that this includes both marine and terminal and industrial. But again, a good development, going in the right direction. Yes, lower than one year ago but now we are in a normal situation where you have to order components, you have to have something on stock. You have to be prepared for good output and short delivery times.

Service is recovering slowly. Yes, if you look at that graph, you take two, four, six… six quarters back it's almost flat. There's not a dramatic increase here and I think that's a… we are working on it all the time. We would like to be better. Marine is slow. Industrial and terminal is growing, but that's how I see it. I hope that we will get a faster recovery here in the future but we also have to be realistic. Earnings per share continue to improve almost 70 cents (?) in one quarter. I think it's not a bad figure. It's actually a very good figure if we can start to be on that level. This quarter, EMEA is slightly bigger than Asia-Pacific. The small percentage changes, that's only a question of deliveries, how the deliveries are timed. You cannot draw any big conclusions from this graph.

The following slides are exactly the same slides as I have shown you before. I just have them here as a reminder for you that this is a strategic journey that we are going and the focus areas are these four areas: Service, takes time to develop it. Customer and customer segments, I think we have done a great job here in understanding our customers and working together with them. I think that we took a very big step in this direction when we are (). We have a very different dialogue with our customers now, because we are the only one in the world who can offer the whole chain from terminal operating systems, automation, equipment, so there we have made a big improvement.

Emerging markets. In Brazil, Russia, Africa, China. I have promised you that China, we have to have a solution for China. One way or another we have to see that we are () well in China within in this year and that work is ongoing. Internal clarity, that's the one project. Common processes, ERP systems, that's only for us to be even more efficient and to reach even higher EBIT than we have in today's targets.

Priorities for 2011 have not changed. Responding to the growing demand, yes, we are still responding to the growing demand. We see that there's a lot of business out there to be taken. Service growth. We talked about that. Customer segments. Yes, we have also said that over the time, we will see how many customer segments can we afford to have. Do we have to divest something to be able to invest in some other areas even more? Position in the Chinese market. I told you about that earlier as well. The work is ongoing. And the ERP

Outlook. We have not changed the outlook. We estimate that the sales will grow approximately 20% this year. The operating margin to be approximately 7% and I think that's it. That's bearing in mind that there is a cost pressure on the market as well. It's not at all an easy journey but we are well on the way and I think the fact that we have a very healthy market situation helps us. So here, thank you very much, I think it is time for questions and clarifications.

Moderator

Okay ladies and gentlemen. We are now ready for questions, in addition to Mikael, we have our CFO, Eeva Sipilä answering your questions. Let's start with the questions from the live audience here in Helsinki, Erkki, please.

Questions and Answers

Erkki – Sberbank

Thanks, it's Erkki here from Swedbank. Question regarding industrial terminals. Do you see more costs pressure on the [unclear] or the commerce side? Karin, that's my first question.

Actually it's roughly the same on both sides. Yes, because it's a component. People are talking about some raw materials are not going up, they're going down but we are actually not buying raw material. We are buying components.

Okay and then: How quickly, if at all, do you expect to catch up with your own price increases going forward?

Of course you have to remember that I would say that the market demand today is on a 75% - 80% level of what it was, which means that all the competitors still have capacity to produce, which means that part of answering that is that it's not that easy to catch it up. Of course, in some markets you can do it quicker, in some markets it takes a longer time.

And finally, linked to that: Do you have to say no in a number of projects because the pricing gets on an unhealthy level?

Yes, of course there are projects where we say no. If we feel that there are some projects that the price level goes to a level which I don't want to take, I think it's better to say no in that case. I mean, there are not that many, but yes, we have a limit. We are not trying to fill our factories. We are trying to make….

I mean, has that number increased?

No, it has not increased no.

Okay, thanks.

Question

Is there coming some big orders in the harbour as a () business under this year?

I think that there are, as I told you, after quarter one, there is almost ten big projects in the world. Very difficult to say when they will materialise, who will get the orders and so on but the number is so big that yes, a number of them will be ordered from someone within this year.

**text here*…so do you think that you are going to stay there and in there coming some changes for example in production?*

In the States?

Yes.

Stay there, yes of course we are going to stay there. It's an important market, it's the biggest economy in the world and there are a number of big port projects there and of course we have our production facility in Kansas; it's also what we have in Texas yes. Yes, we are going to stay there for production as well, for especially the US market.

Erkki – Sberbank

One more question regarding marine. Do you see what's the effect of a changing mix in marine side, more containers offshore and so forth, versus bulkers that you were used to deliver more gear? Margin implications there?

There is not a big margin implication in the mix, no. But the more complicated the ship is, the less number of ships we need, so no, I don't see. I mean, an offshore vessel could be eight times more revenue for us compared to a simple ship. A container ship could be twice or three times more, so you have to look at the various ship types.

The recent trends should be favourable to you?

Let's say that at least it's not unfavourable to us. Let's put it this way. As I said many times about ship types, when you look at the ship types, remember that we have nothing to offer for tankers, nor cruise vessels, so those ship types are of no interest to us, but the rest of the ship types are.

Question

They look at your order book, so is it the right conclusion that you have won more market sale in this industry and marine business?

I think that we have won market share in some ship types and maybe we have lost in some, so the overall market I would say that roughly the same. We are the biggest in the market but I would not say that our market share ahs neither dropped nor increased.

Moderator

Now I think we are ready to take questions from the people on the phone lines. Operator please.

Johan Eliasson - Cheuvrex

Hi. I was just wondering a bit about the marine outlook. If you take your backlog into consideration and what you are now seeing will happen with the bulk ships coming down and potentially the container offshore coming up. Are you confident on a flattish revenue development next year or is there some sort of risk that there will be a gap in between these developments and there might be a downward development in your revenues?

Actually, I don't think we have given any guidance for 2012 yet, but answering your question, today I wouldn't say there is a huge risk or opportunity, which means gapped by the positive, no negative way.

Okay, good, and just coming back to the margin in industrial and terminal, you said that you are getting the risk through but then the costs are going and there is price pressure. When is there anything decisive that could eventually make these margins also trend up, get more significantly in line with the volume development? What needs to happen?

Of course our customer needs to understand that they have to pay more but if that's unrealistic…I would say that it's a slower progress than I thought maybe one year ago. There is nothing super specific that needs to happen. It's daily work and of course when the market is picking up then you can be more selective on the projects and be able to take only those projects where the margin is high enough. I think that that's… there is no magic solution to this.

Is that in any way related to more Chinese players trying to enter I guess the port trade of the market. Is that an issue for pricing for you or?

Of course there is as I said, maybe 75% or 80% is the utilisation rate, so anyone can today offer on any projects and they don't have a capacity constraint. Yes, there will be capacity constraints on components but not on their own production and if you add to that that they are saying some of the Chinese players being very aggressive in some markets, so the total, yes of course, the answer is yes. And that's why I said that we have to succeed in China, because if you don't succeed in China you will not succeed in anywhere in the world.

Tom Skogamn – Handelsbanken, Helsinki

I have two questions. First on the port side, you have not booked any projects really this quarter, but if you get them in Q3 or Q4 are the delivery times in these kinds of projects short enough, so it has a severe impact or material impact on sales already next year, that's the first question.

Yes, when we talk about these ten projects, some of the projects are mega projects that are discussed now and they will not have an impact on 2012, but some of them are, the medium sized projects, and they definitely have an impact 2012.

The second question is about the underlying leverage. I realise there's a lot of squeeze on your prices compared to component () costs, but what is happening to the underlying cost *absorption? Is it going as planned? When you get back the sales margin in the industrial and terminal business perhaps next year, it's all good or what is happening underneath?*

I would say that it's going exactly as we have planned, yes. I don't know, but do you want to add something?

I think overall the absorption is going in the right direction. Of course we have a bit of a development issues ongoing that adds some costs that were mentioned early on in the ERP and those sorts of developments in Singapore and the like, but again they are very much in line with our strategy and a very cautious position, so we will continue with them.

But just looking at the number of employees, they're up in industrial and terminal by 18% year on year, which is not as much as the number of…the sales number is up, but it's still a significant number, so I'm just wondering about these cost cuts compared to…you're hiring a lot of people now at the moment now it seems to me.

That's correct, I think we have about an 800-900 person increase within industrial and terminal and close to 500 of that is from acquisitions and Navis is obviously bigger when we have some other ones and then the rest of the increase is then partially related to the ramp up of our operations to deliver the higher volumes and then some investments in headcount as well related to these projects I mentioned.

Tekka Polander – Pohjola Bank, Helsinki

Two questions: first concerning industrial terminal, you have reorganised your production structure quite a lot; is all this job done already or is there still something to do and will be see some pressure on the margins from these actions. Related to this, do you still have some extra inventories, for example in different places, because the organisation is not yet finalised?

We have a bit still of duplicate inventory what comes to the ramp up in Poland between Tampere and Poland, but as we've indicated, that is going according to plan and will not be an issue in 2012.

Then if we talk about your first question, no, it's not as we have seen a revolution, we've had to close a lot of factories and so there is an evolution, yes, that maybe we have to reduce a bit here and add in another area, but it's more like normal business.

So nothing special going on at the moment.

Of course there are special things going on at the moment, but no, nothing related to that, sorry, I have to answer that.

About the margin in marine, as you said that you have already indicated very strong margin will gradually come somewhat down, but actually haven't seen that. What do you expect for the coming quarters and what's behind actually after this very strong performance? Is the sales mix different or are the costs favourable in marine or explain this very favourable development.

During the time when we ramped up and when we had this very high order book and we came to this 15.8 and we thought that it will come…we looked at history how it will come down, but during that same time, we made the marine machine even more efficient and it was very difficult for us to say how will it be in the medium term. Will it go down, will it go down to 13, will it go down to 12, but now we can see that it's a very functioning machine. You can say that we have a good volume, we don't have an increase of number of employees, so it's all these small things that are still ongoing in marine and they compensate for whatever price increase there is in the market. It's just a positive development. Again, nothing magic, many small things, very competent organisation.

Related to this, have you already delivered all these, let's say, high margin orders you took before the financial crisis or is there still something in the order book?

Something small, yes, but not substantial, not a substantial amount anymore.

Still one question in Helsinki.

Erkki – Sberbank

Erkki from Sberbank again. Regarding your Polish factory, it's been running up more than a year already, how would you describe the capacity utilisation there and on the other hand you talked quite a lot about a new sourcing chain there closer to the factory; where do we stand now?

Capacity-wise, those of you who have seen the factory, you can see that there are actually three parts of the factory. There's the left part, the central part and the right part. If I just give you a rough figure. Two-thirds are full in the factory. That tells you something about the capacity. We have added about 100 people to that.

100 people additional which is then according to plan.

According to plan. Again going back to Tom's question earlier that there's an added number of 900 people, 500 from Navis and then we have added 100 in Poland and then a few other places, so I don't see it very dramatic. Then your second question was…

About the sourcing chain.

Sourcing chain, yes, we are wheeling up the sourcing chain and it takes actually a longer time than we optimistically had thought, maybe according to our plan, yes. Why are there () component in the market as well? There were many small manufacturers of components and medium size on our industry. Some of them, they closed down during the recession, some of them managed to survive, but some of those who managed to survive, they are not financial in a very good shape, so it's not only to move. Yes, we could maybe find cheaper components in former Eastern Europe, but we are a bit scared of going with some components there, because if the sub supplier cannot financially, and we have to start supporting it financially, so it just takes time. It's well on the way, but it doesn't happen overnight.

Closing Comments

I think it's time to conclude the second quarter and wish you all very nice and sunny summer. Thank you.