West UC

Moderator: Jaakko Eskola
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OPERATOR: This is Conference #3990234

Jaakko Eskola: Good morning, everyone and welcome to (Wärtsilä) Corporation's Q1 Report session. Here, everyone welcome here in the Wärtsilä Helsinki campus and of course everybody on the lines.

I will make a short presentation, then we have time for questions and answers. And with me here – actually in the front I have the heads of the businesses and our CFO. And almost the – actually, the whole board of management is helping me this morning.

I will start by talking a little bit about the market and the market environment, and I start with marine. The marine recovery is actually quite slow, and there you can definitely see the demand outlook on merchant and Offshore which is cautious, and that has been there for many, many quarters if you go back in history.

On the other hand, again, you see good development and anticipated growth to continue in the LNG, cruise and ferry segments.

Energy, our story and the – and the fundamental drivers – on the energy demand when you look at the emerging markets and at the same time the increased need for flexibility to the renewable transition remains in place.

However, you know – all know that geopolitical risks, global uncertainty and the redefining of investment strategies, to me, all these ambitious renewable targets is slowing down the decision making temporarily,

I would also highlight this moment that this is the first time we now come out with two divisions and the report is also reflected to that point. And this organizational change we initiated last year is actually paying off.

You can definitely see a better understanding about the market, a better focus, bringing value to our customers and at the same time, you can see it here in Wärtsilä, how people are working and delivering the results.

Then moving on – some of the key figures, order intake went down a bit, and that's mainly driven by the new building energy orders. And as we know, all these years energy goes up and down during quarters.

Order book, highest ever, went up 15 percent. And it's always interesting to add to that number, the orders we don't book in services, which is 1.4 billion, and – so we have a fantastic order book.

Net sales, up, mainly marine, new building deliveries and the services growth both in marine and energy, book to build at a healthy level.

Comparable operating result – the absolute number went up 16 percent, and also we saw a better number on percentages. EPS at the same level and now cash flow – cash flow also on the Q1 going to the – to the right and healthier numbers.

Now, in our presentation, we also wanted to show the rolling numbers of order intakes and sales and profitability, and then you can see here how stable – a little bit going up the trend, but how stable the quarters actually are.

If you look at Marine and Energy, Marine was 60 percent and Energy 40 percent, what comes to the – to the equipment side in – during this quarter. And the slow decision making has affected energy orders this quarter.

Net sales growing. And happy to see that sales in Services, which we also wanted to show going forward, is around 50 percent of the net sales. And again, the stability slowly going up if you look at the rolling numbers.

(Book to bill) – I mean this trend going up and the (book to bill) at the – at the healthy levels. Order book distribution, this is of course, good to look at the yearend and then the years to come.

At this moment, I would – I would like to highlight that reaching our targets and the growth for this year, we still need energy orders going forward. This has always been the case and no drama there, but those orders have to come – and energy's actually turning around a bit faster.

We still have a lot of orders in and getting orders in the – in the Marine sector where the deliveries are a bit longer than compared to Energy. Now, finally also looking at the – at the result numbers, it was a good quarter, but quarter is a quarter, and then always, you need to be looking at the trends.

But I want to highlight that when you look at the mix, when services is growing and the – when the focus is on the – on the value deliveries and the value bring to our customers the profitability will also grow.

Cash flow, positive as compared to last year. And working capital, OK, a bit down from last year, but increasing from the end of last year, and of course, a lot of good support also when you look at our advances and inventories going forward. Gearing 0.29.

And moving on to the businesses, slow recovery in the marine segments. And if you – I mean here you have on the left side, the total order, contracts, I think it was over 200 vessels is a bit more than last year, but I think everybody anticipated the market to pick up a bit faster.

As everybody knows, Clarkson has also downgraded a bit their longer term forecasts. And at the same time on the right side – on this slide, you see the specialized tonnage, which is supporting of course Wärtsilä's solutions more favorably.

Order intake development, here you see also – you can see the growing rolling numbers. Overall order intake in Marine went up, new equipment a bit more than services and (the division with) different segments is pretty much what it has been during the last quarters.

Good to see the installed base coverage – we have been talking about that a lot, and the long-term services are important for us. And there is a good example of one customer – LNG tankers are good examples because they have dual-fuel engines and complicated – sophisticated, I would rather say, equipment and solutions, where Wärtsilä can provide value to our customers.

Net sales development, up compared to last year, and also the rolling number again here is visible. Services, 50 percent compared to new equipment which is – which is a good number. And of course, you can see also that division between spare parts and agreements and field service and projects, so, healthy, healthy development on that side.

And on one example of what has been going on during the first quarter, Wärtsilä is providing a solution, the new (Wasaline ferry), which is (kind of – I would rather) call it as a – as a lab ferry which has a lot of new installations, new innovations, hybrid dual fuel solutions, enabling the reduction of CO2. Wärtsilä will be there on the service side, providing again, maintenance and services improving the reliability.

And it's as I call it, a lab because it has a possibility to develop and test and research different kind of new elements, what you have in the – in the marine segments today.

Moving on, Energy – and I start by showing the slide which clearly shows where Wärtsilä plays a role going forward. We all know coal and fossil fuels are targeted today – and I – it's not new that coal will or should be disappearing first. Then you look at different fossil fuels and the cleaner the fuel, the more possibilities it has. At the same time, renewables playing a stronger role.

The importance of this graph is that on the – on the fossil fuel and the gas side, you need more solutions which are flexible, decentralized, and that's why engine technology plays a – an important role.

Our orders on energy services, there was a growth, but new equipment it was – it was down. And I have highlighted already a couple of times the reasons there. And then you can also see here how the orders go up and down.

Again, the long-term story has not disappeared anywhere. And that's why we strongly believe that we have a very strong role to play when you look at the renewable – renewables coming more into the picture.

And examples of our services contract, again, now there was a pick up on the percentages, which is good, supporting our strategy. This is a – this deal – five-year deal in Myanmar, where Wärtsilä will operate and maintain a power plant for their developing infrastructure going forward.

If you look at the global numbers – highlights are there that Africa and Middle East have been growing, and you have a very healthy division between Asia, Africa, Middle East and Americas. Europe is a bit slow during this quarter.

Net sales development – and you always compare the net sales of course, how orders have been coming in during the last 12 months and – but here is also good to see services growth and services forming over 50 percent of the energy sales.

Market share, OK a bit old data, but in a – in a shrinking market, Wärtsilä is gaining a bit market share.

And then a – then one example where the market is growing, and we have been talking about different fuel and fuel strategies and our flexibility when it comes to different fuels, that the new, very interesting – not a new innovation, but the way how to – how to fuel different equipment are the cases of power-to-x.

And there is a small Finnish startup called Solitair Power, who is developing the technology to produce from CO2 and hydrogen a synthetic renewable fuel.

Solitair is an – is a fantastic example of a company, which is also looking at the healthy working environment, because their technology is actually taking the CO2 from, for example, office environment, and then we would have a healthier air here to breathe and have our meetings. And then converting that CO2 back to renewable fuel. And that fuel can be burned in Wärtsilä engines. And we can basically call our engines to be renewable products.

This is not the only company in the world, and as you remember last year, we also announced a – our cooperation with LappeeNranta University and Nebraska, the biggest utility in (Nebraska) where we are testing, in the larger scale, power-to-X story.

And I think this is – this is a – this is the way how you can look at different possibilities that again, based on our strategy to work on different fuel flexibilities.

And the final slide, our prospects are unchanged. Solid for Marine and Services, at the same time as I highlighted at the beginning, Marine a slow recovery, and Energy is slowness in the decision making, long term story is there, but also for us, we need energy orders, more than this quarter to go – to go forward.

And I stop here, and let everybody to start asking questions. So, do we have any questions here in Helsinki Campus – from the audience? No questions yet. And then we could turn to the – to the lines, please?

And may I remind, one question and then one repeat question, and then please go back to the line. I think we can roll it up quickly, and you have possibility to ask many questions. Please?

Operator: As a reminder, ladies and gentlemen, it is star and 1 to ask a question. And your first question from the line of Max Yates from Credit Suisse. Please go ahead.

Max Yates: Hi, thank you. My first question is just on the Energy division, and I wanted to understand specifically which regions were giving you confidence and where you saw the healthy pipeline that was going to result in orders picking up as we go through the year?

Jaakko Eskola: Thank you. Very good question, and I – I could answer that one, but I let Marco, because it's his specialty, Marco Wirén, the Head of Energy to answer to that one. Please, Marco?

Marco Wirén: Thank you. And thank you for the question as well. And of course, the Middle East and Asia is (a big) important area for us, and we definitely see a good pipeline there. We have a lot of countries that still are growing, and they need energy to be able to grow.

And – but also if you look into Southern America – Latin America, we see that Brazil will get back to the auctions. We will have one option in May, then in the fall there will be more auctions. And next year, we will see more specific peaker auctions as well.

And we see also that there are other places like United States still and Australia, where the backup power for renewables is very important. And – but of course, just like Jaakko mentioned earlier today, that there's a lot of re-planning to be made in many states in United States, where politicians have been demanding the increase, the share of renewable.

And of course, when they have to go back to the drawing tables, it takes some time, and then they have to get the decisions made again. So, that’s why we see a little bit slowness in the decision making.

Jaakko Eskola: Central America also?

Marco Wirén: Yes. Yes, definitely Central America as well, the whole Latin America. (Yes).

Max Yates: Is there anything we should read into – I mean I noticed kind of recent orders in Nigeria, Iraq was sort of 28 to 48 million megawatts, is there anything we should read into those orders in the Middle East and Africa, just being fundamentally smaller than we have seen in Bangladesh?

Marco Wirén: Yes, I would say that we've been talking about that Africa will come, and I will say that finally, we see movement in Africa, and we definitely believe that next coming five years, we will receive more orders from Africa, than we have received the past five years.

The Middle East is also an area where we see opportunities. And Iraq is one of those, and there's a lot of need for them to transform their whole energy sector from dependency of other countries into becoming more domestic player.

(Mark Fiat): OK. OK, and maybe just one – maybe just one follow up on SOx scrubbers, could you help us understand in Marine how much SOx scrubbers accounted for orders?

And maybe comment on how you think the market will evolve in the coming quarters, relative to that number? Because obviously, it's quite a sizeable amount of your 2018 order intake.

Jaakko Eskola: Thank you. Yes, Roger Holm, Head of Marine, he knows the scrubber market.

Roger Holm: Yes, thank you for the question, and if we first start by looking at the Q1 order intake, it was on a good level, slightly less than comparable quarter last year, but still on a good level. We see still a lot of interest in the markets. That has not reduced as we see it now.

The key question that we have is how will now the fact change the market – that if you want to have a scrubber 1st of January, you should have ordered one already.

And now, we need to follow how will the owners then decide based on this one. So, I think this is the key question point. But a good activities ongoing still and the pipeline also looks positive.

Jaakko Eskola: Thank you, Roger.

Max Yates: (OK, could you just)…

Max Yates: Could you just give us a sense of how much the orders were down sequentially? Just at least in magnitude…

Roger Holm: I would just comment that it's a slight decrease compared to Q1 last year, but still on a good level.

Max Yates: OK, that’s great. Thank you very much.

Jaakko Eskola: Thank you.

Operator: Your next question from the line of Andreas Willi of JP Morgan. Please go ahead. Andreas, your line is open.

Andreas Willi: Yes – sorry for the delay. It's Andreas from JP Morgan here. Could you just elaborate on the uncertainty in the energy market, in terms of the customers that you mentioned? Because they don’t seem to have uncertainty when it comes to pulling the trigger on the actual investments or renewable power. Solar, wind volumes continue to grow very strongly and surprise on the upside.

What specifically do they need to pull the trigger on kind of the peakers, the backup for the renewable, given that that market hasn’t grown in the last three, four years, despite the extraordinary growth in renewables? What are they waiting for specifically that should then come in the next 12 months, 18 months?

Jaakko Eskola: Please, Marco?

Marco Wirén: Yes, thank you, very good question. And usually, it depends how much renewables you have. And we usually talk about a tipping point of 20 percent.

And when they decrease, for example coal and other resources that they have or generation, then when the tipping point is closing to 20 percent, then they usually realize that they need a very good balancing power and peaking power as well.

But the slowness that we see now is basically because of the redoing of the plans. So, it's not because of that that they are not reaching the 20 percent. And that’s the case in all markets. And it always depends how big the market is, so how much they have interaction with the other utilities as well in the area.

Jaakko Eskola: Thank you.

Andreas Willi: But what should change in the next 12 to 18 months for that to basically catch up and deliver the growth you expect?

Marco Wirén: Of course, we see that the share of renewable of their generation capacity is increasing. And that’s where they're closing to this tipping point.

And the other reason is that when they are redoing their plans, we see a slowness now, but they have to continue to invest because they need the electricity. And that’s why they will continue to increase the renewables share. And that’s where peaking power is coming in.

Andreas Willi: Thank you.

Marco Wirén: Thank you.

Operator: Thank you. Your next question is from the line of Johan Eliasson from Kepler Cheuvreux. Please go ahead.

Johan Eliasson: Yes, hi, this is Johan –terrible echo, but I hope you can hear me…

Jaakko Eskola: Yes.

Johan Eliasson: … so, sorry to coming back to scrubbers again. Your Swedish competitor claim that the margins for the deliveries they had for the scrubbers was clearly above 15 percent. Is that something you are seeing as well? And if not, why?

Jaakko Eskola: Thank you for the question, Johan. I don’t want to comment on anything what Alfa has told. And I – we don’t – we don’t comment on our scrubber margins.

The only part what we have been commenting earlier during last year, were that some of the initial scrubbers, early on were on a lower level, but then they have been getting on a – on a healthier level, but no other comments on the margin side.

Johan Eliasson: OK, then on the other ballast water, any actions there from your side?

Jaakko Eskola: Yes, Roger, please?

Roger Holm: Thank you for that question. Yes, more activities in the pipeline, and we expect that still to – as a general comment, the market will probably increase towards end of next year 2021. Still if we look at the volumes in relation to the rest of our business, we are still on low levels – low levels.

Johan Eliasson: OK, thank you.

Jaakko Eskola: Thank you, Johan.

Operator: Your next question from the line of Sven Weir from UBS. Please go ahead.

Sven Weir: Yes, good morning from my side. So, two questions please. The first one is on the service business, and obviously you now had an encouraging development in the second quarter in the row, and I was just wondering how you look at the sustainability of that, especially as far as the spare parts business is concerned? That would be the first question. Thank you.

Jaakko Eskola: Thank you, Sven. And as I – I started by talking about the new organization. And that's the – I think the reasons why we can see – I mean hopefully of course, one quarter is always one quarter, but we should start seeing more healthier development on services.

I have always been talking about the focus on how we deliver value to our customers. And on the spare part side, of course, we – I mean on that side, we have dedicated actions going on already some months, and you can start seeing the benefits of those.

I mean customers want to see some value and then they make decisions. And that's a – that's of course, one reason for the – for the healthy development.

And I shouldn't expect anything else to happen going forward with both divisions.

Sven Weir: OK, good. And the follow up question I had was just also is regarding to IMO 2020, obviously the other option is to use low sulphur fuel.

Is there anything you see in the new builds that is changing in the engine design? If ship owners just using low sulphur fuel, is the design any different? Less equipment? Less service intensive compared to heavy fuel oil?

Jaakko Eskola: Roger, please comment on that one.

Roger Holm: Yes, thank you for the question. I think we are – we are on the part as we have discussed very much before. We see more and more interest into LNG as a fuel and that goes to all segments.

And then you have so much scrubbers that you will be able to install in the fleet and the rest, then we'll have to comply by – on the fuel side. But direction wise, I don't see any change compared to what we have said before.

Jaakko Eskola: Some of the payers will go for low sulphur fuel…

Roger Holm: Absolutely.

Roger Holm: … for years and…

Roger Holm: Yes.

Roger Holm: … and never change.

Roger Holm: But there is also listening to the ship owners, there is quite a lot of debate what to do on the scrubbers or low sulphur fuel. And future will then tell what is right. And probably, you need to look at where you operate, how you operate and so on, then make a decision based on that.

Sven Weir: I was also just wondering technically if the design of the engine is to be any different or the pre-treatment, given if you burn low sulfur against high sulfur, is there much of a difference?

Roger Holm: For our engines, now. That's not a major issue. Of course then, when you go to LNG, then we talk about a dual fuel engine, so that's then the major difference.

Jaakko Eskola: I would rather go to gas, nothing else.

Sven Weir: OK. Thank you, guys.

Jaakko Eskola: Thank you, Sven.

Operator: Your next question is from the line of Manu Rimpelä of Nordea. Please go ahead.

Manu Rimpelä: Good morning, could you please comment on the divisional margins? I would like to better understand what was behind the reason for Marine margins coming down in the first quarter compared to last year?

Jaakko Eskola: Thank you, Manu. The basic reason for different margins is the mix. And basically, there is things and smaller things here and there, but the mix is very important.

I mean and not only the mix between services and new building, but also what you actually deliver during that quarter.

We might have projects going out where margins – original margins have been a bit lower, and vice versa. So, there is – and then probably you will start seeing this comment going forward also when the – when the profitability varies during the – during the quarters.

Manu Rimpelä: OK, and are you able to comment in terms of the scrubbers? I mean obviously, you mentioned that the early scrubber had lower margins, so what is the impact on the scrubber deliveries?

And if you're not providing us delivery numbers, it's really hard for us to kind of assess the ramp up of the scrubber deliveries.

Jaakko Eskola: I think we can provide the sales number, and Roger, please comment.

Roger Holm: Yes, on the sales side, I can comment. Q1 we were in the range of 50 million sales, and then for the rest of the year, we have still an order book about 400 million, but there and that’s the but – biggest part of that are retrofit deliveries.

And there, there are many factors outside our control that might impact this. So, we at least expect to see some moments on that, but that's how we look at…

Jaakko Eskola: But the retrofit numbers will be in new building numbers…

Roger Holm: Correct…

Jaakko Eskola: … not in services…

Roger Holm: … yes. But these, in this case if you talk about scrubbers going to existing vessels.

Jaakko Eskola: Yes.

Manu Rimpelä: OK. Finally on the scrubbers still, so you are making positive margins in scrubbers even though the lower margin in the initial deliveries?

Roger Holm: I will not comment more on the scrubber margins than what we said, that’s the – comparing to the original deliveries, which were more challenging, we are on a good level as we speak.

Manu Rimpelä: Thank you.

Jaakko Eskola: And our aim is to be on a – on a good level, that’s definitely the strategy.

Operator: Thank you. Next question from Robert Davies of Morgan Stanley. Please go ahead.

Robert Davies: Yes, so thank you for taking my question – my question is just around the Energy business, whether you can give us some color on the split of how much of those in the first quarter went to kind of backup renewables, rather than –sorry, to providing power towards renewables rather than just sort of baseload backup power in emerging markets? If you could give us any color please?

Marco Wirén: Yes, very good question as well. And about 30 percent were backup power for renewables in Q1.

Robert Davies: OK. And then just in terms of the sort of customer behavior on the service side, can you just give us a little bit more color in terms of what's going on regionally in terms of service trends? Are you seeing any particular differences between the regions on service – on energy specifically?

Jaakko Eskola: Yes, please.

Marco Wirén: Yes, I would say that it depends quite a lot what type of customers we have. If it's utilities, they usually have their own service people, and they don't always sign a contract with us.

Where we have IPPs and industrials, they're more keen on signing a contract with us because they don't have their own resources. So, this is, I would say, the main factor that determines if we have a signed contract or not.

But even if utilities don't have a signed contract with us, they usually keep a their assets in a good shape, so they buy spares and additional services when they need more high tech competencies.

Jaakko Eskola: And Roger, can you comment on Services in Marine? That's a – that's a – that's a bit different than what's going on in energy.

Roger Holm: Yes, thank you, and I would comment then more, from a segment point of view. I think we are seeing good development on cruise side and on merchant side.

And also, some, if I call it, small signs on increase on the offshore side on the services side, not on the newbuild yet, but some small signs of bigger activities on offshore side. So, I would lift up those three segments. Thank you.

Robert Davies: That’s great. Thank you.

Operator: Your next question is from the line of Edward Maravanyika. Please go ahead.

Edward: Yes.

Jaakko Eskola: … the program – yes, the program as such – as we initiated it, has started as planned. And of course, it has all kinds of actions. One was to look at the capacity cost, and then we were looking at the sales and supply and the spare parts, and so on.

And as we commented earlier, the plan was to save 100 million, the cost being 75 million. And really, the savings will start during the latter part of the year, and then finally, 2020.

And that's probably also how actually the costs are going on. But as I said, it's working as planned. And then we expect to get those savings as promised.

Edward: OK, understood. And then just a follow up question on spare parts particularly within marine. How would you describe that qualitatively versus last year? Are you seeing lots more confidence compared to last year or are your customers still reluctant?

Jaakko Eskola: In Marine?

Edward: Yes. On spare parts in particular.

Jaakko Eskola: Spare parts, yes, and…

Roger Holm: And on spare parts in particular, you saw we had the 4 percent growth on the service side, and this very much also goes to the spare part activity.

So, I would say, good development market is still cautious, so we need to follow up how this will continue then in the coming quarters. But I'm happy with the developments so far in Q1.

Edward: OK. Thank you very much.

Jaakko Eskola: Thank you, Ed.

Operator: And your next question is from the line of Sean McLoughlin of HSBC. Please go ahead.

Sean McLoughlin: Thank you, can I just come back to the – this idea of the tipping point driving peaker demand. If I understand it correctly, we have greater share of renewables already in developed markets, particularly in Europe, which is also the region where you actually have lower order intake. And this business has historically been focused on emerging markets.

Should we therefore think more about in the longer term as other markets in emerging markets, come up to this tipping point), that is when peaker demand will boom. In other words, we could be several years away from a peaker growth story.

Marco Wirén: Thank you. Very good point. As I said earlier, each market are quite different. In Europe, there's an overcapacity of the electricity, even if the share of renewable is quite high, but there's a lot of overcapacity in Europe, and – which is actually taking all the balancing power.

But of course, when we see that more and more countries will take down the nuclear and coal facilities in Europe, that means that the balance will be different, and that’s why we also said that we've been quite careful about the future sales in Europe, and this is the reason.

But for example, UK has decided that they will take down the coal by 2025. And Germany will take down the nuclear by end of 2021, and decrease the coal, and finally ’38 – 2038 they will take down the coal totally.

So, these different develops – developments will affect the balance of the market. But if you go to United States, which is – you know, a different case, where they actually are closing down coal power plants before the end of the lifecycle, just due to the monetary reasons, it is more beneficial to invest in renewable and having a peaking power – or balancing power for that renewable asset.

And that's why we see more development in the United States. The same in Australia, they're taking down the coal power plants and then putting up a lot of renewable, and that's why they have ordered balancing power– or backup power as well.

Sean McLoughlin: Understood. Thank you. If I could just follow up as well, I noticed that you no longer include the quotation activity slide, if you can just comment on how the volumes and mix in quotation activity developed since the previous quarter?

Male: I would say that it's been quite stable – the reason we don't have that because quite often when you have auctions for example, and then they might pull back the auction or they don't actually order anything from the auction. And then the auction comes up again a little bit later.

So, that's why it was a little bit shaky up and down the figures as well, but what we said earlier, the pipeline is healthy, and the drivers are there.

But also, if you look to page 19 in the presentation, you see that Bloomberg new energy finance, their predictions of peaking power – and you can see that 2020, their prediction is that it will go down.

And it's a quite tiny little part of that bar, but if you – if you enlarge that, you can see that. And then we see as well, and that's pretty much the reason that was already mentioned, that redoing the plans and that's the major reason.

Sean McLoughlin: Thank you.

Marco Wirén: Thank you.

Jaakko Eskola: Thank you.

Operator: There are no further questions at this time. Please continue.

Jaakko Eskola: And do we have any further questions here in the audience? No? Then we will close here and thank you all participating – wonderful questions, and let's meet again in July. Thank you.

Operator: That concludes presentation today. Thank you for participating. You may disconnect.

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