Deco Media
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Chaired by Anna Tuominen

Anna Tuominen

Good morning ladies and gentlemen. My name is Anna Tuominen and I am from Sanoma's IR team. I would like to warmly welcome you to hear about our Q3 results. Before we start, a couple of practicalities; the event is webcasted and you can follow it live on our website, Sanoma.com, or later on demand. We will first hear a presentation by CEO, Harri-Pekka Kaukonen and CFO Kim Ignatius, and after that you will have time for questions, first here in the room and then over the phone. If you would like to ask questions over the phone you will find all the instructions on how to join the conference call on our website as well.

Harri-Pekka Kaukonen

Ladies and gentlemen, welcome also on my behalf to our Q3 Results Review. If we look at Q3, the sales top line grew pretty much at the same pace as we have seen before. The adjusted growth rate was about 1%. The operating profit in absolute terms declined but, corrected for the impact of the structural change related to the SBS transaction, we actually are pretty much on a comparable level. I would characterise that as a solid performance under an economic environment which was actually quite volatile during Q3.

We had a number of one-offs during Q3, really driven by the change in the economic outlook of the CEE countries, specifically in Hungary, and also the impact of exchange rates contributed to this big number but, all in all, a solid Q3 and our expectations for Q4 contribute that we maintained the outlook of the Group unchanged for 2011. The big event during Q3, obviously, was the closing of the SBS deal and the fact that we have now started the integration and take-over of SBS as an asset, and I will get back to that a little bit later. We have also continued working on the transformation and have started to set new priorities for the coming strategic period, and I will talk a little bit more about this as well, as we move forward. You cannot escape talking about the environment and the changes in the media landscape and I will do it this time as well, to remind you that there is a fundamental change ongoing in the industry, driven by technology. We are seeing the changes in customer behaviour, how customers and consumers spend their time and also what they are expecting from a media company and the services.

This shift in time spending also impacts the way advertisers see the market and they are also thinking about how to adjust their advertising spend. But these are also opportunities, specifically for media companies that have the local presence, the consumer contacts, the extremely good relations with the advertisers and also strong content and brands. And for a company like Sanoma we need to continuously develop our technology skills and improve our service capabilities in order to take advantage of these opportunities that digital transformation presents us. This impacts in a similar way both the consumer media businesses and learning, and one of the key thrusts of our company going forward is to push in developing our capabilities in this transformation. We see that as a quite interesting opportunity for us.

Sanoma is a very dynamic company which is undergoing a big transformation. This year – I have referred to this on many occasions already, but in a way everything is moving – our strategic focus is becoming clear; the priorities are really on building and further strengthening the customer insights that we have the relationship with the consumers and the advertisers, the teachers and the municipalities.

It is really about digital transition and making sure that our core business in the classical media, print media and print publishing transforms in a good way into the digital environment and, mind you, it's not only digital; many times it is a combination of print and digital which is the winning combination as we have seen for example here in Finland with the extremely well accepted combo subscription of Helsingin Sanomat. That's a big component of innovation and media companies, and we need to become better at innovating and also scaling what we have in-house. We have lots of creative ideas and experimentation going on and, when we have been looking at it, there are some quite solid growth opportunities that we see.

We have to also address competitiveness and cost efficiency, and that is the fourth element of the drivers or the focus areas in defining new strategies. These lead to a set of new priorities and I will shed some light on that in a minute. We have since August a new management team in place, and I am really proud to say that we have one of the most international management teams in a media company. There are 5 nationalities represented in the management team now and this new team has now worked for about 3 months. The third component is the ongoing portfolio change. We have communicated constantly that consumer media, news, online TV and magazines, is one of the legs and learning is the other one. As you have seen, we have continued on this path. During Q3 we closed a number of divestments and, as already mentioned, the SBS acquisition which is really the big one, was closed during the summer. This work will continue and, as we have announced, we are looking for new owners for the Trade assets and when the time comes hopefully we will have something to communicate around that.

A couple of words about SBS; we have now, since the beginning of August, been involved with it. If you just look at the market development, the viewing shares are somewhat lower than we expected – that's a fact, but we are very positive about the asset. It is a great company, good people and, combining with our capabilities and assets in the Netherlands, Sanoma-wide and also with our partner, I am sure we will be able to take this company forward. We have taken a number of steps; both in Holland and in Belgium we announced a new CEO for our SBS asset in the Netherlands and there are also other changes in the top team that have been made and announced and, all in all, I think we are now in a good track to work with the programming side making sure the programming is aligned with the customer, the channel profiles and that we restore a winning culture in the company. This is the work now which of course is of utmost priority for the whole Group as we move forward.

Finally, a few words about the strategic priorities that we have set – if you look at the operation, the first one is really to take care of our print platform. It is to continuously develop our content and our brands. We are a market leader in most of our markets in magazines or newspapers where we are present. Today there was an announcement regarding the Finnish operations where we will really recreate and further develop our leading titles in Finland and also restructure the portfolio. This I think is a great example of how we manage and continuously innovate and recreate our strong titles and brands.

The second priority is in our TV business. Sanoma today, pro forma, has about a €400 million TV operation, all in all, and it is of utmost importance that we continue to develop that organically in the free-to-air space, but also transform TV into the digital area. Learning is similarly in focus. We have a good track record of good organic growth in learning. Our ambition is to continue with that, and also in the learning space enable the transformation from content to learning outcomes which is really another digital transformation. We are quite far in that; in all of our countries we are the leading digital learning player and there is a lot of digital platform development that will enable us to offer learning solutions in the future and we are already doing that in many countries.

The fourth thing, which is not a separate thing but actually very integrated with these other priorities, is that of creating new types of services that many have a strong digital component and we have worked, and are working very hard in pushing these forward. We have some great examples - as already mentioned the combo subscription of Helsingin Sanomat, and today we actually announced that we will combine the newsrooms of Helsingin Sanomat and Nelonen, and that is quite a unique combination of a modern future newsroom that will be able to combine content of all the different platforms and create new types of news offerings to consumers. I am very excited about that. That is one example of the new type of thinking that is emerging in the company.

Apart from these operational strategic priorities we need to take care of our financial flexibility, our cash flows and also the operational cost base, and that is something we will continue to work at and with the leadership, especially of Kim and Jackie, our HR, we have programmes under this umbrella. The third but not the least is the culture of transformation to take Sanoma into a clearly high-performance culture but also to make sure that our behaviours and mindsets are aligned, and also our capabilities with the future requirements. Out of these priorities, this one is the most important. If we don't succeed here then it is going to be much more difficult to achieve the other objectives that we have set. Along with these, there are a number of operational priorities and goals, which we will refer to later, in the future, but I just wanted to share with you some of the directions where we are headed with the company. I think we are in a good way and taking good, solid steps in executing and implementing our strategy.

With that, I would like to leave the word with Kim, who will go through the Q3 performance in more detail. Thank you for your attention.

Kim Ignatius

Good morning, everybody. My name is Kim Ignatius and I am the Group CFO of Sanoma, and also on my behalf a very warm welcome to all of you.

I will now walk through some of the main financial points in our Q3 reporting. Our net sales for the quarter were at the level of 720 million, a growth of 4.4% quarter-on-quarter. The growth is of course driven by the acquisition and now consolidation of the TV operation of SBS in Netherlands and Belgium. This acquisition, of course, also changes the mix in our sales. We now have 26% of our total net sales coming from advertising sales and these sales grew by 34% compared to last year's Q3. The transaction also impacted our circulation sales, which grew by 2% quarter-on-quarter, supported by Veronica Publishing. Within the circulation sales trends we see subscription sales growing somewhat and the single copy sales coming down slightly.

Our EBIT for the quarter was €79 million. Within this EBIT we have 23.3 million of one-off transaction-related costs and transaction related order backlog amortisations. Our EBIT margin for the quarter was 11%. If you would correct to these one-off items actually, the margin would be higher than the 13.7 level in Q3 last year. Our EBIT for the quarter is a negative one, -17 million; all in all it includes 97 million of non-recurring items, mainly impairments of assets but also some portfolio restructuring related losses.

Earnings per share, excluding non-recurring items, was €0.28 for the quarter. This is decline from the level of 43 cents last year, of course impacted by the one-offs that I mentioned, but in addition to those impacted by transaction financing related fees and costs from last spring and also now by the higher indebtedness in our balance sheet. Cash flow €0.68 – actually fairly close to the levels that we had last year – we start seeing the positive impact of the operational cash flows from SBS and naturally the amortisations and impairments that do impact our EPS, do not impact the cash flow per share.

Number of employees – going down in FTE numbers by 6.6% and this is driven by the divestments that we have done in our Trade division and also we have closed quite a few kiosks in the kiosk business and to some extent this declining trend has been offset by the acquisition of SBS and the new FTEs joining us. We grew in net sales from 690 million to 720 million, so 4.4% growth, 1% organic growth in the Media operations – you see a 58 million growth and this is as mentioned coming from the TV operations, but outside that we also see a 1.4% organic growth in our Media operations, driven by advertising sales growth as well as a good development in our Finnish TV operations, so a very positive quarter actually for the Media operations overall.

In News we see a negative growth of 1.6 that relates to some structural changes, Esmerk being moved to Learning earlier and Lehtikuva not being part of our operations anymore; adjusting to those we have 2.1% organic growth which stems from the advertising sales. For Learning actually flat sales and a bit of negative organic growth compared to last year's Q3 – this is based on lower sales in general literature, the asset we have now sold and it is also based on the economic environment in Hungary, impacting our Learning business in that country. Trade going down by 27 million – this is because of the divestments we have done – organically the operation is growing by roughly 1% and we are actually very pleased with how the kiosk operations are developing in terms of sales and also in terms of profitability. Also our Trade services are doing well.

Looking at EBIT excluding non-recurring items, we did have a good month in Media in Q3. The underlying results did improve. The SBS consolidation, on the other hand, turned this to a negative delta of -5.1 million, so we have a positive impact of the SBS operations itself but negative impact of the one-off items that I have mentioned. News has had a very strong year and accumulatively so far, Q3 was a bit weaker quarter sales-wise. At the same time there were increasing levels of development activities. We do have a higher paper cost level this year than last year and there is some wage inflation which led to a decline of 3.2 million. Learning EBIT came down by 3.4 million quarter-on-quarter, with some timing differences between the years but the weakening result is mainly because of Hungary and our operations in that country, and also a lower margin level in YDP's operations in Poland.

Cash flow from operations from 174 million last year, now down to 133 million this year. For the 9-month period, if we first look at the business operations then we do have a negative impact on the cash flow from some of the assets that we have sold, mentioning two big ones here – one is the broadband Welho operation that still was part of our numbers in 2010 and then the movie operations that were sold last spring. Positively, of course, SBS brings a good cash flow addition into our flows.

Some negative items - transaction costs related to the SBS transaction impacting our cash flows a bit, about €10 million worth; higher interest paid related to higher leverage, roughly 5 million impact here, and then we had higher financial items mainly related to the transaction from spring plus some increases in FX losses that relate to SBS programming right purchases and, all in all, this is about 10 million, compared to last year's Q3. Higher taxes paid, about 15 million, partly timing issues – we'll probably recover part of it during Q4 – but also because of deferred tax payments from 2010. Positively our net working capital has been very well under control and, if we compare this 9-month period with last year, we have a positive delta of 18 million. Cash flow is definitely one of the highest priorities that we currently have in this company – a lot of focus put on it this year, but also going forward.

Looking at our balance sheet, and from the impairment perspective you know that Q3 is the time when we run our annual tests. We currently have a balance sheet with total assets of 4.3 billion, a major increase from Q3 last year - with the SBS consolidation we added about 1.2 billion into the total asset amount. Non-current assets totalling 3.6 billion, of which goodwill represents 2.2 billion, and you can clearly see here that the majority of the goodwill we have in our balance sheet relates to the Media Netherlands operations. In addition to the goodwill we have other intangible assets worth 730 million.

We now took an impairment totalling 85 million and the main areas are two – first the assets that we have in Media Russia and CEE were 53 million and as Harri-Pekka mentioned, this is because of the difficult economic environment in Hungary and some other CEE markets, plus some foreign exchange related developments. These two explain a significant portion of this impairment. In Language services it is the worsening outlook of the business that led to this 24 million impairment. We have tested all our cash-generating unit segments as well as intangible assets that are to be tested separately and, in all the other areas except for these two, we are in good shape.

Looking at capital structure, here is a graph showing two of the main financial indicators related to capital structure; equity ratio and net debt to EBITDA. You see here, after Q2, the impact of the SBS transaction. In our Q2 reporting we gave an estimate how the post-transaction situation would look and now, when we look at the Q3 levels, we can see that our actual numbers right now are very much in line with the plans that we had before closing the SBS transaction. Regarding EBITDA, in these KPIs it is based on pro forma rolling 12-month backward numbers.

What is important with our capital structure is that our ambition is that, to ensure financial flexibility, we need this to be able to develop our businesses going forward and to have financial flexibility it is important that we get back to a credit profile that would be an investment grade type of profile. We have two tools to achieve this; one is the focus on the operational cash flow and the other one is the divestiture of non-core assets. Finally, the outlook for 2011 is unchanged; net sales are expected to be at previous year level and the operating profit excluding non-recurring is expected to decrease somewhat.

This ends my part of the presentation and we are now ready to take questions.

Questions and Answers

Questions from the floor

Sami Sarkamies – Nordea Markets

I have a question on your TV operations in the Netherlands and in Belgium. In the presentation you mentioned that the share of viewing has gone down from last year. Could you describe the market situation in general in these countries, with regards to TV, and then maybe some remarks on how the acquisition has gone from your perspective – any surprises so far?

The TV market in general has grown this year and SBS unfortunately has lost some viewing share. I think the declining development as such is not something we didn't expect. The reasons behind that are simple – it's related to the programming investment – we need to invest more in programming and we need to make sure the programme is also aligned with the channel profiles. That has been a challenge. Also the asset was in a selling mode which meant management had other priorities also to take care of, the daily business, so we restored that with new leadership, new direction to the team, and we recruited a new CEO and strengthened the team both in Holland and Belgium. Of course the competition has not stood still and when there is a change of ownership they've done their best to challenge us. It is fair to say that the viewing shares have been a bit further down than what we had expected, but the drivers we knew behind it.

I have a second question with regards to your capital structure that you intend to develop. In Kim's presentation you mentioned two tools to do this. Could you just give us a couple of examples of how you can still improve cash flow? Secondly, is there anything else you could consider divesting in addition to things you have been talking about previously?

You can go back to Harri-Pekka's presentation as well and look at the key targets that we have set ourselves; of course the basis is the operations itself to make sure we continuously take care of the profitability of all our businesses, both the traditional print and media businesses plus the new ones and, as mentioned, there are a lot of efforts that we are doing to be able to accomplish that. That is one thing.

Then of course net working capital is an area where we have programmes being put in place right now, actually, to look for additional liquidity globally from our operations. Opex efficiency target is another area where we are starting a Group-wide effort looking into all our support function processes and that of course will now have an impact on the coming quarter, but on a mid-term basis it will help us to accomplish better cash flows, so going through all parts of the operation and making sure the cash flows are in focus and we find more efficient ways of running our operations.

Secondly, the divestments – you have seen quite a bit taking place already and, as indicated, there are some assets that are not strategically in the core and we are looking into those. I will not want to mention any specifically.

Matti Riikonen - Carnegie

Regarding the TV businesses in Holland and Belgium, if I continue with that topic – could you describe a bit about the advertising purchasing patterns of your advertising customers – how much is spot buying versus frame agreements and how do the ad prices react to the changes in viewer shares? I am trying to understand what kind of viewer shares the current advertisers are buying and if your figures are lower now, will it trigger some negative outcomes going forward a bit, or is it just spot which reacts automatically to any changes you might have? Also, going forward, if you manage to get the viewer shares back up, how soon does that reaction take place?

I'll start with the last question which is that to restore the viewer share it is a 12-18 month journey to build it, so it takes some time just starting from natural lead-times of redesigning the programming before you implement that and before you get the full impact. When it comes to pricing of advertising space, so far we haven't seen any dramatic change and when it comes to the actual numbers I do not remember them off-hand, I don't know if you Anu remember, but maybe that is something that at a later stage we can open up a bit more on the structure of advertising market.

Anu Nissinen - CEO of Sanoma Media Finland

Most of the advertising is bought by frame agreements and also of course most of the advertising is spot advertising. However, in the Netherlands, there is a bigger share of also non-spot advertising than for example in Finland and of course the non-spot advertising also follows somewhat the viewing shares, so there is a close link between those two. The actual prices are not so much impacted because advertisers of course buy GRP-based contacts, so the pricing itself is not impacted by the viewing share.

Matti Riikonen - Carnegie

Regarding the Learning division, the problem in Hungary – is it an isolated case with less money available from the public buyers or is there a danger that similar problems might pop up in other countries as well? We are entering into a phase where public spending is not growing, so at least in the meantime when the electronic learning platforms start to take more space, what happens in the meantime – is there a danger that you might face declining demand before you get into the electronic space in full force?

Our view is that this is an isolated problem. Hungary is really in severe economic trouble and there is also a political regime that is rethinking their education policies, so there are extremely high austerity measures. Schools are copying instead of buying books, so it is quite an extreme scenario that we have in Hungary. We are not seeing that kind of development in any of the other countries. It is true that governments have to rethink where they spend, but at the same time the educational sector is one of the strategic priorities for them and there is continuous development of curricula and systems, so there is a balancing act. For us it is a Hungary-specific problem.

Bengt Dahlström - Swedbank

I have two questions. First, on the SBS operations, can you tell anything about the margin development there? The business has had very high margins. Have they been stable or changed in any direction in Q3? Secondly, with the remaining assets in Trade division, do you plan still to divest in this year or maybe not before next year?

I'll start with the last one - I cannot comment on this – when we have something to report we'll tell you. Regarding the margin itself, TV is a scale business so if you lose viewing share it will impact your margins, but we are not revealing or commenting on the actual numbers. There is some impact.

Mark Braley – DB London

Good morning. Just one question on SBS again, I'm afraid. You have referred to extra investment in programming. Could you give us some kind of quantification of how much more that will be in cash terms? Should we be thinking €10 million, €30 million, or €50 million – kind of just a broad-brush guidance on that would be very useful.

Our policy – we have not commented on individual cost items and I would prefer not to do it here, but I think your unit of calculation is not far off.

Mikael Doebel – Handelsbanken Helsinki

Still one question on the SBS TV assets – in terms of the outlook for Q4 in this business, some of your competitors are seeing, especially the Dutch ad market outlook as fairly challenging; how do you view this market?

It is true that that's also what our SBS people say that Q4 is a bit softer. That is the view right now. At the same time we have seen that the advertising markets have been very volatile in the Benelux, so one week from the other almost there is some big change, but that is true; we have the same view that Q4 is a bit softer.

Then, on the priorities that you mention in the report, one was to ensure the financial flexibility of the company; how does this fit with your dividend policy? How should we think about the dividend going forward?

When it comes to actual dividends I cannot comment anything, obviously, but we have not communicated any change into the overriding dividend policy.

What I said also before, when this transaction was planned for, the lowering of dividends was not in the toolbox as a source of financing so, as Harri-Pekka said, our policy is stable and of course the characteristic for the Company has been to have stable payouts, but the world is changing around us and you never know where we are going to be next spring, so no firm commitments on anything can be delivered.

Maybe a question to Kim as well – in terms of costs, do you have the figure for the year over year change in operating expenses, excluding the non-recurring items and changes in the structure, for the first 9 months?

If we put it that way, we have two items where we see a clear increase; one is paper cost, where we see roughly a 3% increase year on year. Volumes have come down of course as well during the year so the impact of the price increase leads to a total impact of 3% salary - employee benefit costs have increased 4% year on year – those are the two main items.

Finally, also to Kim on the loan covenants, you say that you have headroom to the financial covenants – could you elaborate a little on that – do you have some headroom, much headroom? Could you give any more colour on that?

Regarding the financial covenants, I am sleeping very well. There is adequate headroom.

Good, thank you.

Closing Comments

We would like to thank you for your attention and wish you a nice day.